



# Accounting System Requirements and Pre- Award Audits

Further information is available in the  
Information for Contractors Manual under Enclosure 2

# Prior to First Cost Type Contract Award

- Contracting Office or DCMA conducts Pre-award Survey to consider responsibility of prospective contractor
- Design of the Accounting System is part of the Preaward Survey (SF 1408 Criteria)
  - Link: <https://www.dcaa.mil/Checklists-Tools/Pre-award-Accounting-System-Adequacy-Checklist/>
- DCAA is requested to evaluate design of Accounting System and report back to Contracting Office or DCMA

# Contractor Qualifications

## Responsible Prospective Contractor Criteria:

- Adequate financial resources to perform the contract
- Ability to comply with the required or proposed delivery or performance schedule, considering the firm's existing commercial and governmental business commitments
- A satisfactory performance record
- A satisfactory record of integrity or business ethics
- The necessary organization, experience, accounting, operational controls, and technical skills to perform the contract
- The necessary production, construction and technical equipment and facilities
- **Eligibility to receive the award under applicable laws and regulations**

# Pre-award Audit Objectives

- Evaluates design of Accounting System to determine if it is **acceptable** for prospective contract
- Contractor should be prepared to **demonstrate** how accounting system design satisfies SF 1408 during audit fieldwork stage
- DCAA Pre-Award Accounting System Audit Program:  
<https://www.dcaa.mil/Portals/88/Documents/Guidance/Directory%20of%20Audit%20Programs/17740%20Preaward%20Survey%20of%20Prospective%20Contractor%20Accounting%20System%20AP.pdf?ver=w0ujMZRuYOzWedf4w7EYVg%3d%3d>

# Standard Form 1408 Criteria

SECTION II - EVALUATION CHECKLIST			
MARK "X" IN THE APPROPRIATE COLUMN ( <i>Explain any deficiencies in SECTION I NARRATIVE</i> )	YES	NO	NOT APPLI-CABLE
1. EXCEPT AS STATED IN SECTION I NARRATIVE, IS THE ACCOUNTING SYSTEM IN ACCORD WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES APPLICABLE IN THE CIRCUMSTANCES?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. ACCOUNTING SYSTEM PROVIDES FOR:			
a. Proper segregation of direct costs from indirect costs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Identification and accumulation of direct costs by contract.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives. (A contract is final cost objective.)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Accumulation of costs under general ledger control.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
e. A timekeeping system that identifies employees' labor by intermediate or final cost objectives.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
f. A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
g. Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
h. Exclusion from costs charged to government contracts of amounts which are not allowable in terms of FAR 31, Contract Cost Principles and Procedures, or other contract provisions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
i. 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 proposed contract.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
j. Segregation of preproduction costs from production costs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. ACCOUNTING SYSTEM PROVIDES FINANCIAL INFORMATION:			
a. Required by contract clauses concerning limitation of cost (FAR 52.232-20 and 21) or limitation on payments (FAR 52.216-16).	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Required to support requests for progress payments.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. IS THE ACCOUNTING SYSTEM DESIGNED, AND ARE THE RECORDS MAINTAINED IN SUCH A MANNER THAT ADEQUATE, RELIABLE DATA ARE DEVELOPED FOR USE IN PRICING FOLLOW-ON ACQUISITIONS?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. IS THE ACCOUNTING SYSTEM CURRENTLY IN FULL OPERATION? (If not, describe in Section I Narrative which portions are (1) in operation, (2) set up, but not yet in operation, (3) anticipated, or (4) nonexistent.)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

# Acceptable Accounting System

## DFARS 252.242-7006(a)(1):

“a system that complies with the system criteria in paragraph (c) of this clause to provide reasonable assurance that—

- (i) Applicable laws and regulations are **complied** with;
- (ii) The accounting system and cost data are **reliable**;
- (iii) Risk of misallocations and mischarges are **minimized**; and
- (iv) Contract allocations and charges are **consistent** with billing procedures.”

# Defining an Accounting System

## **DFARS 252.242-7006(a)(2):**

“the Contractor’s system or systems for accounting methods, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for reporting in compliance with applicable laws, regulations, and management decisions”

May include subsystems for specific areas such as:

- Billing
- Labor

# Total Contract Costs

- The total cost of a contract is the sum of the direct and indirect costs allocable to the contract.
- While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31 and applicable agency supplements.

<b>Direct Costs</b>			
<b>Direct Labor Category</b>	<b>\$</b>	<b>Qty</b>	<b>Total</b>
Engineer 1	\$ 25	100	\$ 2,500
Engineer 2	\$ 35	150	5,250
Engineer 3	\$ 50	200	10,000
<i>Total Direct Labor</i>		450	\$ 17,750
<b>Materials (Less Scrap)</b>			
<b>Type</b>	<b>\$</b>	<b>Qty</b>	<b>Total</b>
Widget 1	\$ 100	100	\$ 10,000
Widget 2	\$ 500	150	\$ 75,000
Widget 3	\$1,000	200	\$ 200,000
<i>Total Materials</i>		450	\$ 285,000
<b>Total Direct Costs</b>			<b>\$ 302,750</b>
<b>Applied Indirect Costs</b>			
Engineering Overhead	35%		\$ 6,213
General and Administrative	5%		\$ 15,448
<b>Total Indirect Costs</b>			<b>\$ 21,661</b>
<b>Total Contract Costs</b>			<b>\$ 324,411</b>



# Direct Versus Indirect Costs

DFARS 252.242-7006(c)(2) requires proper segregation of direct costs from indirect costs.

- Direct Cost is any cost that is identified specifically with a particular final cost objective.
- Indirect cost means any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective

# Defining Costs

- DFARS 252.242-7006(c)(3) requires identification and accumulation of direct costs by contract.
- DFARS 252.242-7006(c)(4) requires a logical and consistent method for the accumulation and allocation of indirect costs to intermediate and final cost objectives.

# Direct Cost

- Direct costs are not limited to items that are incorporated in the end product as material or labor.
- No **final cost objective** shall have **allocated** to it as a direct cost any cost that has been included in an **indirect cost pool**.
- Direct costs of the contract shall be charged directly to the contract.

# Definition of an Indirect Cost

- Identified with two or more final cost objectives or an intermediate cost objective.
- An indirect cost is not to be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of any other final cost objective.

# Indirect Cost Overview

- The number of indirect cost accounts in a single company can range from one to hundreds.
- The indirect structure needs to be tailored to your company and how it operates.
- In general, indirect cost accounts fall into two broad categories:
  - Overhead
  - General and Administrative (G&A)

# Overhead Pools

Cost related to support of specific operations

Examples of indirect cost rates include:

- Material Overhead
- Manufacturing Overhead
- Engineering Overhead
- Site Overhead

# General and Administrative

These are management, financial, and other expenses related to the general management and administration of the business unit as a whole. To be considered a G&A expense of a business unit, the expenditure must be incurred by, or allocated to, the general business unit.

Examples of G&A expenses include:

- Salary and other costs of the executive staff of the corporate or home office
- Salary and other costs of such staff services as legal, accounting, public relations, and financial offices
- Selling and marketing expenses

# Allocation Base Overview

- Indirect costs should be allocated based on benefits accrued to intermediate and final cost objectives.
- Allocation base must be reasonable.
- There must be a relationship between the selected allocation base and the pool costs.
- For example, training costs in the overhead pool are not necessarily caused by a particular cost objective, but the cost objectives might benefit from the training of employees. In that case, training would be related and benefit the labor dollars incurred on contracts/final cost objective.



# Allocation Base Examples

In general, typical allocation bases for Overhead and G&A are:

## Overhead

- Direct Labor Dollars
- Direct Labor Hours
- Direct Material Dollars

## G&A

- Total Cost Input (Total direct and indirect costs minus G&A)
- Value Added (Total Cost Input less subcontracts and direct materials)
- Single Cost Element (e.g. Direct labor dollars)

# Allowability

## FAR 31.201-2

A cost is allowable only when the cost complies with all of the following requirements:

- Reasonableness
- Allocability
- Terms of the contract
- **Applicable Cost Accounting Standards (CAS)**
- Any Limitations Set forth in the entire Subpart 31.2

# Reasonableness

## FAR 31.201-3

FAR considers a cost to be reasonable if:

- In its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- It is the contractor's responsibility to establish that each cost is reasonable.

# Allocability

## FAR 31.201-4

A cost is allocable to a government contract if it:

- Is incurred specifically for the contract;
- Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

# Contract Terms

- Specific types of cost are often addressed in a contract or request for proposal (RFP).
- However, the contract terms can only be more restrictive than the other factors that must be considered in determining cost allowability, not less. In other words, the contract terms cannot allow a cost that is:
  - Unreasonable
  - Improperly measured, assigned and allocated to the contract
  - Unallowable in accordance with specific cost principles

# Accounting for Contract Costs

- The accounting system must be able to accumulate and report the costs for each final cost objective; i.e., government contract.
  - Direct costs of the contract, plus
  - Allocation of applicable indirect costs, less
  - Unallowable Costs

# DFARS Accounting Requirements

## **DFARS 252.242-7006(c) requirements:**

- (5) Accumulation of costs under general ledger control
- (6) Reconciliation of subsidiary cost ledgers and cost objectives to general ledger
- (7) Approval and documentation of adjusting entries
- (11) Interim (at least monthly) determination of costs charged to a contract through routine posting of books of accounts

# Labor System

## **DFARS 252.242-7006(c) requirements:**

- (9) A timekeeping system that identifies employees' labor by intermediate or final cost objectives
- (10) A labor distribution system that charges direct and indirect labor to the appropriate cost objectives



# Timekeeping

- Labor should be charged to intermediate and final cost objectives based on a timekeeping document (paper or electronic timecards) completed and certified by the employees and approved by the employees' supervisors.
- Employees should fill out timesheet on a daily basis and include all hours worked including uncompensated overtime.
- Labor cost distribution records should reconcile to payroll records and labor distribution records should trace to and from the job cost ledger and general ledger accounts.

# Unallowable Costs

DFARS 252.242-7006(c)(12) requires “Exclusion from costs charged to Government contracts of amounts which are not allowable in terms of Federal Acquisition Regulation (FAR) part 31, Contract Cost Principles and Procedures, and other contract provisions”

- Therefore, contractors need written policies and procedures to identify and exclude unallowable costs.
- Unallowable costs need to be identified and excluded from any billings, claims, and proposals applicable to a Government contract.

# Costs by Contract Line Item

DFARS 252.242-7006(c)(13) requires “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”

- Therefore, the accounting system needs to be able to expand beyond a project number.
- Each job needs to be expanded to the requisite level of detail as determined by contract terms.
- Make sure the contract is adequately briefed to determine what this level might be.

# Invoicing Requirements

## **DFARS 252.242-7006(c) requirements:**

- (16) Billings that can be reconciled to the cost accounts for both current and cumulative amounts claimed and comply with contract terms

# Overview of Invoicing

Contractors should only bill cost which comply with FAR 52.216-7

- Recorded costs that have been paid by cash, check, or other form of actual payment for items or services purchased directly for the contract
- When the Contractor is not delinquent in paying costs of contract performance in the ordinary course of business, costs incurred, but not necessarily paid, for supplies and services purchased directly for the contract and associated financing payments to subcontractors, provided payments determined due will be made:
  - In accordance with the terms and conditions of a subcontract or invoice; and
  - Ordinarily within 30 days of the submission of the Contractor's payment request to the Government

# Basis of Invoiced Costs

- Billings need to be based on current contract provisions. The total amount billed should not exceed any contract, work order, funding limitation, or any other contract ceiling amount.
- Important to brief contract to identify billing provisions, including but not limited to:
  - Restriction of billing frequency
  - Special withholding provisions
  - Contractual unallowable costs
- A contractor needs to reconcile booked costs to billed costs.

# Cost Accounting Information

DFARS 252.242-7006(c)(15) requires “Cost accounting information, as required—

- (i) By contract clauses concerning limitation of cost (FAR 52.232-20), limitation of funds (FAR 52.232-22), or allowable cost and payment (FAR 52.216-7); and
  - (ii) To readily calculate indirect cost rates from the books of accounts”
- Interim rates should be routinely monitored.
  - At least monthly, an employee needs to be responsible for monitoring total contract expenditure against contract limitations on price or cost.

# DFARS Cost Accounting Requirements

**DFARS 252.242-7006(c) requires:**

- (17) Adequate, reliable data for use in pricing follow-on acquisitions; and
- (18) Accounting practices in accordance with standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, Generally Accepted Accounting Principles.



# Management Reviews/Internal Audits

**DFARS 252.242-7006(c) requires:**

- (8) Management reviews or internal audits of the system to ensure compliance with the Contractor's established policies, procedures, and accounting practices

# Common Areas of Noncompliance

- Contractors not making Interim (at least monthly) determination of costs charged through routine posting to books of account
- Failure to properly segregate direct and indirect costs
- Improper timekeeping
- Failure to exclude unallowable costs

# Areas of Noncompliance

- Inadequate procedures to ensure that subcontractor and vendor costs are only included in billings if payment to subcontractor or vendor will be made in accordance with terms and conditions of the subcontract or invoice and ordinarily within 30 days of the contractor's payment request to the Government.

# Frequently Asked Questions

- How do I get a DCAA approved government accounting system?  
You cannot. There is no such thing as a DCAA approved government accounting system.
- How do I request a DCAA audit of my accounting system?  
DCAA does not perform audits requested by a contractor. DCAA only performs these audits based on a request from a federal entity who is responsible for determining the acceptability of a contractor's system.

# FAQs Continued

Is QuickBooks or any other accounting software applications acceptable accounting system for federal contracting?

An accounting system is more than just a software package. It includes accounting methods, procedures, and controls. Many accounting software application can be part of an acceptable accounting system or set up in a manner that fails to meet the requirements of an acceptable system.

# DCAA Internet Resources

- **Guidance**

- Audit Process Overview – Information for Contractors Manual
- Directory of Audit Programs
- Contract Audit Manual
- Select Area of Cost Guidebook (FAR 31.205 Cost Principles)
- Links to Acquisition Regulations



- **Checklists and Tools**

- Cost of Money Rates
- Incurred Cost Electronically (ICE) Model
- Contractor Submission Portal
- Adequacy Checklists - Preaward Accounting System, Contract Pricing Proposal, Forward Pricing Rate Proposal, Incurred Cost Submission, Termination Settlement Proposal.

- **Frequently Asked Questions For Contracting Officers, Contractors and COVID-19**

# Small Business Outreach Survey

We would love to hear about your recent experience with the DCAA Small Business Program, as we are committed to providing the best guidance possible and strengthening our nation's Defense Industrial Base. By participating in our survey, you will help us improve our courses, content and provide you with even better support as we continue to grow our program.



# Questions/Comments



Katelyn Rigle

Financial Liaison Advisor- Small Business Coordinator

Headquarters – Operations Audit Liaison Division

8725 John J. Kingman Road

Fort Belvoir, VA 22060

VoIP: (571) 448-6376

E-mail: [katelyn.a.rigle.civ@mail.mil](mailto:katelyn.a.rigle.civ@mail.mil)