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## CHAPTER 2

### 2-000 Preaward Surveys of Prospective Contractor Accounting Systems

#### 2-101 Preaward Survey Overview

A preaward survey is an evaluation, usually made by the cognizant contract administration office, of a prospective contractor's ability to perform a proposed contract. Such surveys may cover technical, production, quality assurance, financial capability, accounting system, and other considerations. Normally, there are two categories of information that DCAA may be requested to furnish. One deals with the contractor's financial capability to perform the contract and the other deals with the adequacy of the accounting system to accumulate the type of cost information required by the contract.

#### 2-201 Financial Condition Risk Assessments or Financial Capability Audits

Financial condition risk assessments or financial capability audits are performed to determine if the contractor is financially capable of performing on Government contracts. These risk assessments or audits may be performed during the preaward or post contract award periods. The type of financial information examined by DCAA consists of such data as: (1) financial statements, including those contained in reports issued to stockholders, lending institutions, and SEC filings, (2) cash flow forecasts, (3) loan agreements and evidence showing compliance with these agreements, (4) aging of accounts receivable and payable, and (5) financial history of the contractor and affiliated concerns, and (6) employee payroll tax returns (Federal). Based on this information, the auditor will make a recommendation to the contracting officer regarding whether or not a contractor has sufficient financial resources to perform the contract.

#### 2-301 Accounting System

##### 2-301.1 Accounting System Surveys - General

a. The preaward accounting system survey is an audit to determine the acceptability of a contractor's accounting system for accumulating costs under a prospective Government contract. The audit scope should be limited to obtaining an understanding of the design of the prospective accounting system so as to appropriately complete the SF 1408, "Preaward Survey of Prospective Contractor Accounting System" (see Figure 2-3-1 and refer to paragraph 2-301.2 for additional discussion), and those procedures essential to reach an informed opinion as to whether or not the design is acceptable for accumulating costs under a Government contract. In addition to the items on the SF 1408 evaluation checklist, DCAA will determine if the system will provide reasonable data for projection of costs to complete a contract.

b. Contractors should recognize that an operable accounting system that is under general ledger control is of paramount importance when performing Government contracts. However, prospective contractors may have no work that requires the same type of accounting system as is needed for Government work. A prospective contractor may not

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want to install a new, more detailed accounting system unless awarded a contract. In this case, if the potential contractor anticipates a contract award, it must have developed a system that is operable, though not necessarily in use. It must be in a position to demonstrate this new system to the auditor and be ready to implement the system prior to incurring any costs on the Government contract. In developing their contract cost accounting systems, new companies often benefit from employing personnel or consultants who understand rules and regulations applicable to accounting for costs incurred on Government contracts.

c. If the accounting system is unacceptable, the auditor will promptly notify both the contractor and the procurement official of the deficiencies, and will usually identify recommendations for correcting the deficiencies. DCAA will not develop the new system, since this is the contractor's responsibility. Once the required corrective actions have been taken by the contractor to correct the deficiencies, DCAA, if requested by the contracting officer, will perform a follow-up audit of the revised system and/or corrected deficiencies.

d. An accounting system audit may be performed after contract award. The major objective is to determine if the contractor's accounting system is adequate for accumulating and billing costs on Government contracts. It is usually performed at the request of the contracting officer when (1) a follow-up to a preaward survey is recommended, or (2) a preaward survey was not conducted prior to contract award, and the contracting officer determines that an audit is now required to support contract requirements. Auditors may self-initiate a post contract award accounting system audit based on audit risk at a contractor location.

### **2-301.2 Detailed Provisions of SF 1408 (Reference Figure 2-3-1, Page 2 of 2)**

a. Proper segregation of direct costs from indirect costs. DCAA will review the accounting system to determine if direct costs are segregated from indirect costs. Direct costs are defined in FAR 31.202 as any cost that can be identified specifically with a particular final cost objective (e.g., a contract). An example would be labor specifically identified to the contract, or materials purchased specifically for the contract. Contractors at times may find it impractical to identify costs specifically to a contract. FAR 31.202 states that a direct cost can be treated as an indirect cost if the dollar amount is minor, it is treated the same way for all contracts in a contractor's accounting system, and that treatment produces substantially the same results as treating the cost as a direct cost. Indirect costs are defined in FAR 31.203 as 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. An example of an indirect cost would be the lighting in a manufacturing area that houses the work of several contracts. The lighting benefits all contracts, but cannot practically be identified to a specific contract. These types of costs are normally placed in an overhead or general and administrative (G&A) expense pool and allocated to contracts on some equitable basis. The cost accounting system must identify what costs are considered direct, and what costs are considered indirect. Once these criteria are defined, they must be consistently applied.

b. Identification and accumulation of direct costs by contract. DCAA will determine if the accounting system can accumulate costs by contract (commonly referred to as a job order cost accounting system).

c. A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives. DCAA will determine if indirect costs are allocated to cost objectives based upon relative benefits received, or other equitable relationship, as required by FAR 31-201-4, "Determining allocability," and 31-203, "Indirect costs." Fundamentally, this means that a cost may not be allocated as an indirect cost to a final cost objective if other costs incurred for the same purpose have been included as direct costs of that or any other cost objective. If superficially similar costs are treated as both direct and indirect costs, the purposes for incurring the costs must be distinguishable. For example, if a contractor wishes to perform a contract which requires three firemen on 24-hour duty at a fixed-post to provide protection against damage to highly flammable materials used on the contract, but the contractor already has a firefighting force for general protection of the plant, which is treated as an indirect cost and allocated to all contracts, the contractor may charge the cost of three of the post firemen directly to the particular contract requiring them. In this example, the contractor may also allocate a portion of the remaining cost of the general firefighting force to the same contract only if the separate classes of firemen can be shown to serve different purposes consistently (that is: (a) costs charged directly to the contract are only costs of three contract-required firemen at a fixed post who are protecting contract materials, and (b) no costs of these firemen are ever included in the indirect cost pool).

d. Accumulation of costs under general ledger control. DCAA will determine if the job order cost accounting system can be reconciled with the general ledger, and that the company accounting system is controlled by the general ledger.

e. A timekeeping system that identifies employees' labor by intermediate or final cost objectives. DCAA will determine whether a contractor's timekeeping system has the ability to track employees' time spent on each work activity. (See Section 2-302 for further information on timekeeping procedures and controls.)

f. A labor distribution system that charges direct and indirect labor to the appropriate cost objectives. This is interconnected with the discussion of timekeeping. Once an employee's time is segregated as described in paragraph 2-301.2e, the costs must be allocated to the appropriate cost objective(s).

g. Interim (at least monthly) determination of costs charged to a contract through routine posting to books of account. DCAA will determine if the accounting system produces appropriate reports that show the results of charges to contracts. These reports should be produced at least monthly.

h. Exclusion from costs charged to Government contracts of amounts that are not allowable pursuant to FAR Part 31, Contract Cost Principles and Procedures, or other contract provisions. The FAR identifies some costs as expressly unallowable: e.g., bad debts (FAR 31.205-3); contingencies (FAR 31.205-7); contributions or donations (FAR 31-205-8); and entertainment (FAR 31.205-14), and requires that they be excluded from proposals and billings. Costs mutually agreed to be unallowable between the contractor and the contracting officer also may not be proposed or billed. DCAA will determine if the accounting system

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**2-302.1 Timecard Preparation**

Detailed instructions for timecard preparation should be established through a timekeeping pamphlet and/or company procedure. An automated timekeeping system uses remote data entry terminals to record labor charging data directly to the computer for processing. Supporting documentation normally consists of machine printouts or reports showing data that, in a manual system, appears on source documents. When a manual system is in place, instructions should indicate that the employee is personally responsible for:

- (1) Recording his/her time on a daily basis.
- (2) Recording time on the timecard in ink.
- (3) The correct distribution of time by project numbers, contract number or name, or other identifiers for a particular assignment. To ensure accuracy, a listing of project numbers and their descriptions should be provided in writing to the employee.
- (4) Changes to the timecard. All changes should be lined through, with the employee's initials beside the change indicating the employee personally made the change and that the change is correct.
- (5) Recording all hours worked whether they are paid or not. This is necessary because labor costs and associated overheads are affected by total hours worked, not just paid hours worked. Therefore, labor rate computations and labor overhead costs should reflect all hours worked. Unpaid hours worked are termed "uncompensated overtime." Solicitations over the simplified acquisition threshold contain the provision at FAR 52.237-10, Identification of Uncompensated Overtime, which details disclosure requirements for uncompensated overtime.
- (6) Signing the timecard at the end of each work period.

**2-302.2 Recommended Timekeeping Policy**

- a. The supervisor should approve and cosign all timecards.
- b. The supervisor is prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on some form of authorized leave. If the employee is on travel status, the supervisor for the employee may prepare a time sheet. Upon his or her return, the employee should turn in his/her time sheet and attach it to the one prepared by the supervisor.
- c. The guidance should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors.
- d. The company policy should state that the accurate and complete preparation of timecards is a part of the employee's job. Careless or improper preparation may lead to disciplinary actions under company policies, as well as applicable Federal statutes.

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### **2-302.3 Floor Checks**

DCAA auditors periodically perform physical observations of work areas and inquiries of employees to determine if: (1) employees are actually at work, (2) employees are performing in their assigned job classification, and (3) employee time is charged to the appropriate job or indirect account. These types of audits are referred to as floor checks. DCAA will perform unannounced floor checks to determine the adequacy and accuracy of the timekeeping system for reimbursement of labor costs under cost reimbursable contracts.

### **2-302.4 Penalties for Labor Mischarging**

a. The manipulation of charges to a contract may be subject to criminal charges under 18 United States Code (U.S.C.) 1001.

b. Subject to the facts surrounding participation, the following can be liable for the violation:

(1) Employees who fill in and sign the timecards with the false information.

(2) Supervisors who approve the timecards with the knowledge that they contain the false information.

(3) Managers and officers who know those facts and make the claim anyway by submitting the invoice based upon the false timecard.

(4) The company, in a case where the falsification is known by individuals who submit or who have authority to submit or disapprove the submission of invoices, or who are of a sufficiently high enough level in the company that the court will impute their knowledge to the corporation.

c. There does not have to be a direct contractual relationship between the Government and the employee who submitted the false timecard for the employee to be liable. A person may be liable even though he or she did not submit the fraudulent claim presented to the U.S. Government.

**Figure 2-3-1 Preaward Survey of Prospective Contractor Accounting System (SF 1408)**

<b>PREAWARD SURVEY OF PROSPECTIVE CONTRACTOR ACCOUNTING SYSTEM</b>	SERIAL NO. (For surveying activity use)	OMB No.: 9000-0011
	PROSPECTIVE CONTRACTOR	Expires: 10/31/97

Public reporting burden for this collection of information is estimated to average 24 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to FAR Secretariat (VRS), Office of Federal Acquisition and Regulatory Policy, GSA, Washington, DC 20405; and to the Office of Management and Budget, Paperwork Reduction Project (9000-0011), Washington, DC 20503.

**SECTION I - RECOMMENDATION**

1. PROSPECTIVE CONTRACTOR'S ACCOUNTING SYSTEM IS ACCEPTABLE FOR AWARD OF PROSPECTIVE CONTRACT

YES  NO (Explain in 2. NARRATIVE)

YES, WITH A RECOMMENDATION THAT A FOLLOW ON ACCOUNTING SYSTEM REVIEW BE PERFORMED AFTER CONTRACT AWARD (Explain in 2. NARRATIVE)

2. NARRATIVE (Clarification of deficiencies, and other pertinent comments. If additional space is required, continue on plain sheets of paper.)

IF CONTINUATION SHEETS ATTACHED - MARK HERE <input type="checkbox"/>			
<b>3. SURVEY MADE BY</b>	a. SIGNATURE AND OFFICE (Include typed or printed name)	b. TELEPHONE NO. (include area code)	c. DATE SIGNED
<b>4. SURVEY REVIEWING OFFICIAL</b>	a. SIGNATURE AND OFFICE (Include typed or printed name)	b. TELEPHONE NO. (include area code)	c. DATE REVIEWED

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FAR (48 CFR) 53.209-1(f)

**SECTION II - EVALUATION CHECKLIST**

MARK "X" IN THE APPROPRIATE COLUMN <i>(Explain any deficiencies in SECTION I NARRATIVE)</i>	YES	NO	NOT APPLICABLE
1. EXCEPT AS STATED IN SECTION I NARRATIVE, IS THE ACCOUNTING SYSTEM IN ACCORD WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES APPLICABLE IN THE CIRCUMSTANCES?			
2. ACCOUNTING SYSTEM PROVIDES FOR:			
a. Proper segregation of direct costs from indirect costs.			
b. Identification and accumulation of direct costs by contract.			
c. A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives. (A contract is a final cost objective.)			
d. Accumulation of costs under general ledger control.			
e. A timekeeping system that identifies employees' labor by intermediate or final cost objectives.			
f. A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.			
g. Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account.			
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.			
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.			
j. Segregation of preproduction costs from production costs.			
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).			
b. Required to support requests for progress payments.			
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?			
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.)			