



PUBLIC
CONTRACTING
INSTITUTE

CONTRACT AUDITING

CONTRACT AUDITING

Curious

Perceptive

Questioning

Attention to Details

“Show Me”

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Good Listener



Good with Numbers

Contract Auditing

- Definitions
- Key Organizations
- Audit Interests
- Generally Accepted Government Auditing Standards
- Audit Access
- Audit Process
- Audit Evidence
- Audit Risks
- Audit Preparation Strategies
- Audit Types
 - Pre / Post Award
 - Proposals
 - Timekeeping / Labor
 - Incurred Costs
- Guidance



Contract Auditing - Definition

- Audit - A formal examination of an organization's or individual's accounts or financial situation (Merriam – Webster)
- Contract Audit – An examination and assessment of performance or information, designed to verify that one or more parties to a contract have complied with the requirements or standards set forth in the contract



Contract Auditing – Key Organizations

- Office of Inspector General
- Government Accountability Office
- Contract Auditing Organizations
 - Defense Contract Audit Agency (DCAA)
 - Public / Independent Accounting Firms



Contract Auditing

Office of Inspector General

- Established to investigate contractual irregularities
 - Government personnel
 - Contractors
- Reports to Department/Agency secretary
- Authorized to issue subpoenas
- Maintains hot lines
- Handles criminal investigations of fraud



Contract Auditing

Government Accountability Office (GAO)

- Agent of Congress, headed by Comptroller General
- Empowered to examine government agencies' contracting practices
- Monitors contractor/government compliance
- Handles protests
- Maintains a hot line
- Investigates special problems at request of congressional members/committees



Contract Auditing

Independent Audit Organizations– Basic Services

- Internal Control Reviews (Business Systems, e.g., Acct., estimating)
- Forward Pricing Proposals / Rates
- Incurred Costs (annual submission, terminations, interim vouchers)
- Regulatory Compliance (FAR, DFARS, CAS)
- Compliance with Contract Terms
- Operational Efficiency (Operations Audits)



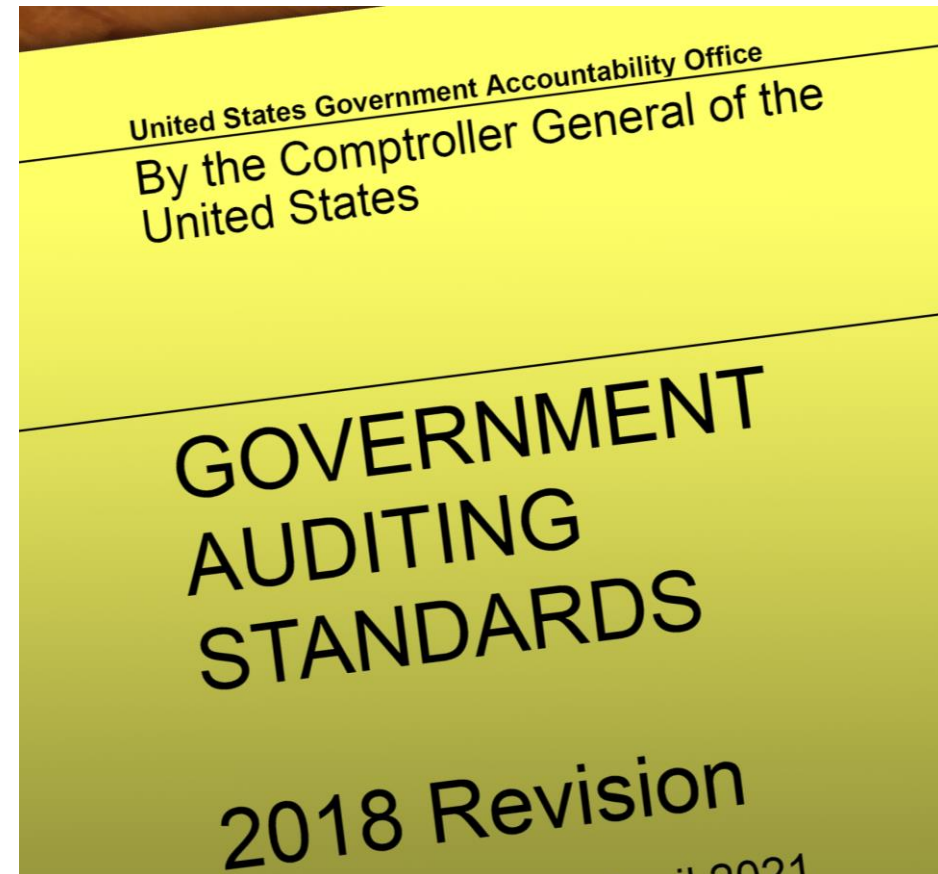
Contract Auditing - Interests

- Identifying and evaluating all activities that either contribute to, or have an impact on, proposed or incurred costs of USG contracts
- Evaluating contractors' financial policies, procedures, and internal controls
- Identifying opportunities for contractors to reduce or avoid costs



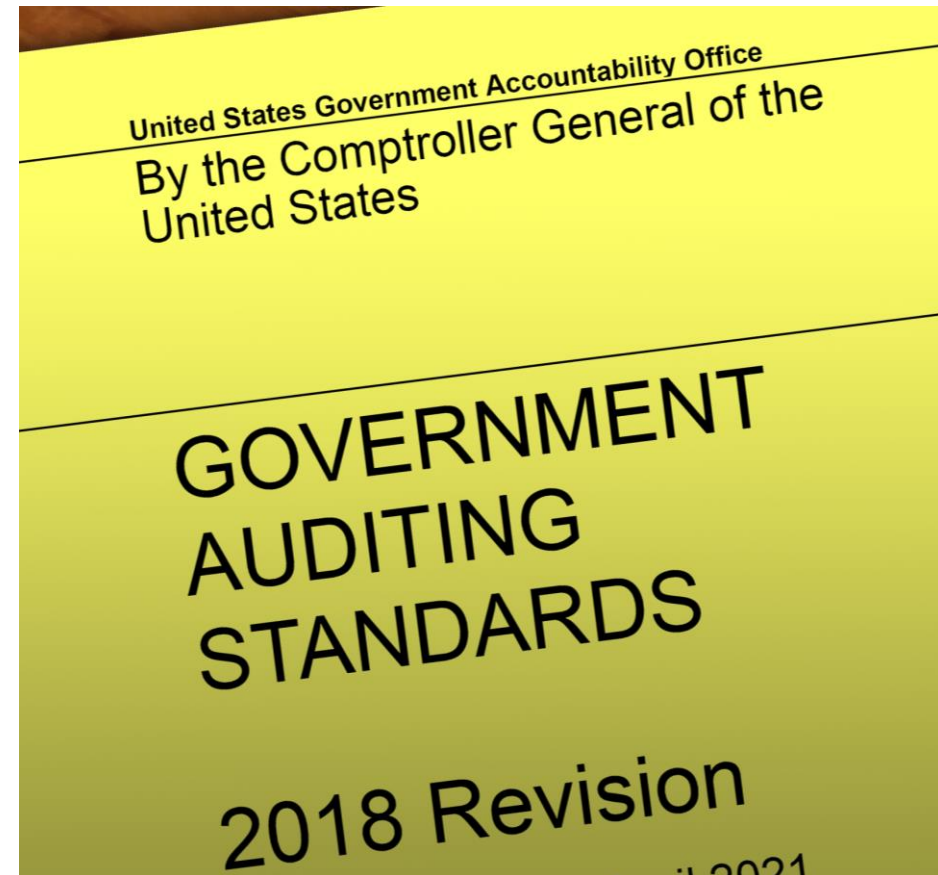
Contract Auditing - GAGAS

- Generally Accepted Government Auditing Standards (GAGAS)
- Perform audits in accordance with GAGAS
 - General Standards
 - Competent
 - **Independent and free of impairments**
 - Documented quality control and review
 - Standards of Fieldwork
 - Adequate planning and supervision
 - **Sufficient, competent evidential data**
 - Design procedures to provide reasonable assurance to detect fraud or other illegal acts
 - Reporting Standards
 - Follow standards for attestation/other types of engagements
 - Attestation – audit must ..state the criteria against which the subject matter was evaluated
 - Compliance with GAGAS stated in reports only



Contract Auditing - GAGAS

- Independence – GAGAS 3.17
 - Auditors and audit organizations must be independent from an audited entity to be capable of exercising objective and impartial judgment
 - Independence of mind
 - Independence in appearance
 - Audit opinions, findings, conclusions, judgments, and recommendations are impartial when viewed by responsible and informed third parties



Contract Auditing – Auditor Access



- FAR 52-215-2 provides the auditor's primary authority for access to contractor records
 - Must be inserted in all negotiated contracts except those:
 - Not exceeding the simplified acquisition threshold
 - For commercial items
 - For utility services
- Provides the contacting officer's representative (auditor) with the authority to examine and audit contractor's books, records, documents, and other evidence and accounting procedures and practices, regardless of form or type

Contract Auditing – Process

- Request for Audit / Self-Initiated Audit
- Establish Audit Team
 - Comprised of auditors and managers
 - Adequacy review of contractor claim/proposal
 - Review of relevant guidance
- Risk Assessment
 - Contract type(s)
 - Procurement environment
 - Significance of costs
 - Business systems processes / Internal controls
 - Past audit experience
- Conduct Entrance Conference (should be “face to face”)



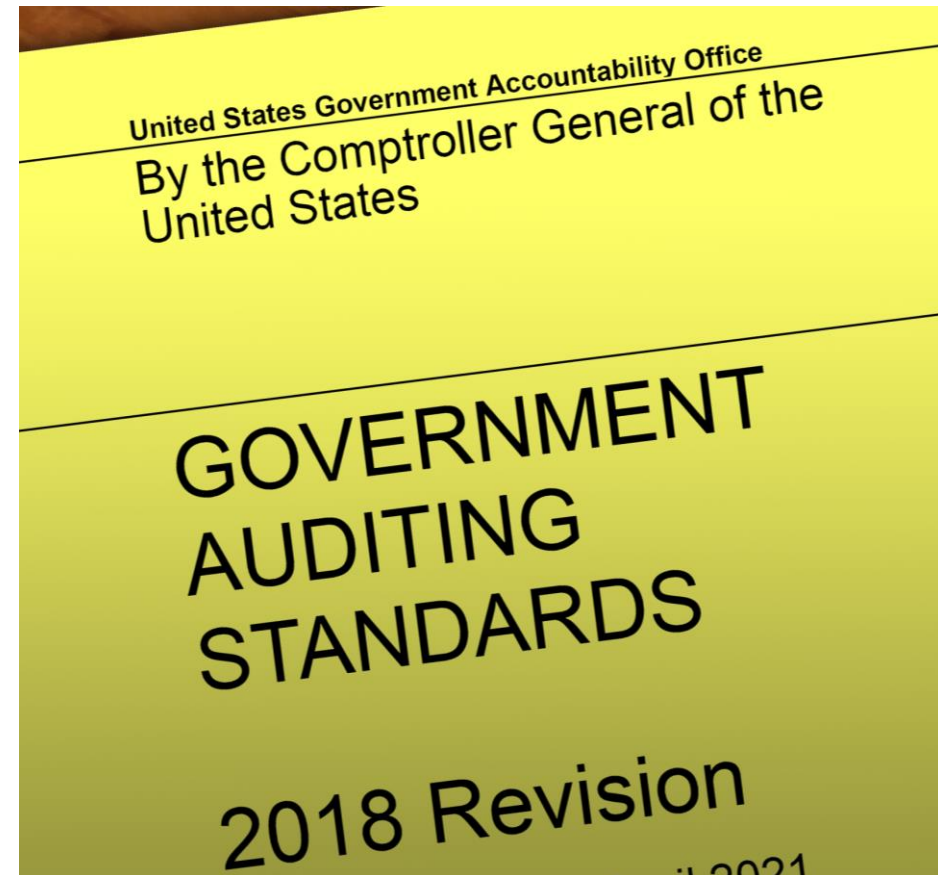
Contract Auditing - Process

- Conduct Field Work
 - Execute audit program steps
 - Gather sufficient evidential matter
 - Develop possible audit findings
 - Discuss potential findings/concerns with contractor
 - Prepare audit working papers
- Develop / Summarize Audit Results
 - Prepare draft audit report
- Conduct Exit Conference (“face to face” unless no findings)
 - Request contractor written response to findings
- Prepare / Issue Final Audit Report
 - Incorporate contractor response



Contract Auditing - Evidence

- Evidence – GAGAS 8.9
- Obtain sufficient, appropriate evidence to provide a reasonable basis for addressing the audit objectives and supporting their findings and conclusions
 - Appropriate – relevant, valid, and reliable
 - Sufficient – enough appropriate evidence to address the findings and support the conclusions that would persuade a knowledgeable person that the findings are reasonable



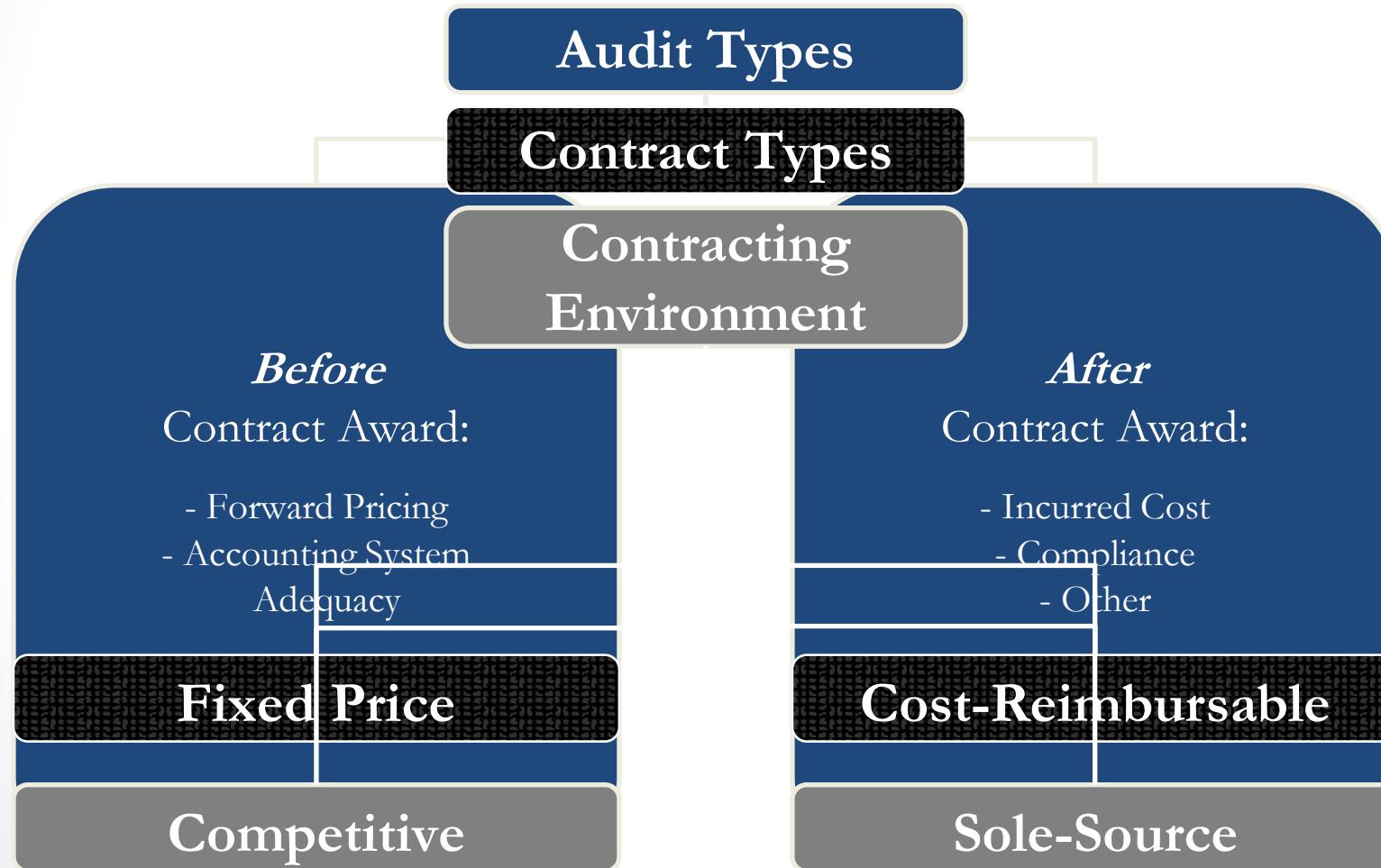
Contract Auditing - Evidence

- Evidence obtained from independent source is more reliable than that obtained from contractor
- Evidence obtained under a good internal control structure is more reliable than that obtained where such control is weak or unsatisfactory
- Evidence obtained through physical observation, examination, computation, and inspection is more reliable than evidence obtained indirectly
- Original documents are more reliable than copies



Better Evidence = Less Transaction Testing

Contract Auditing – Risk Factors



Contract Auditing - Preparation

Audit Preparation Strategies

- Have a general understanding of contracting regulations, FAR, DFARS (Agency supplements), CAS, etc.
- Have read the contracts and understand the terms, conditions, and requirements (including RFP)
- Have an adequate accounting system that will facilitate audit
- Have read pertinent DCAA audit guidance / audit program(s).
- Have well written internal policies and procedures
 - Communicate to employees
 - Document compliance



Contract Auditing - Preparation

Audit Preparation Strategies

- Have an internal audit program
- Organize contract / cost documentation
- Have supporting documentation for cost claims and/or estimates
- Be timely in responses to auditor requests
- Participate in the audit process by providing access to personnel responsible for preparing cost claims and/or estimate:



Contract Auditing – Common Audits

Pre-Award / Post Award Accounting System Reviews

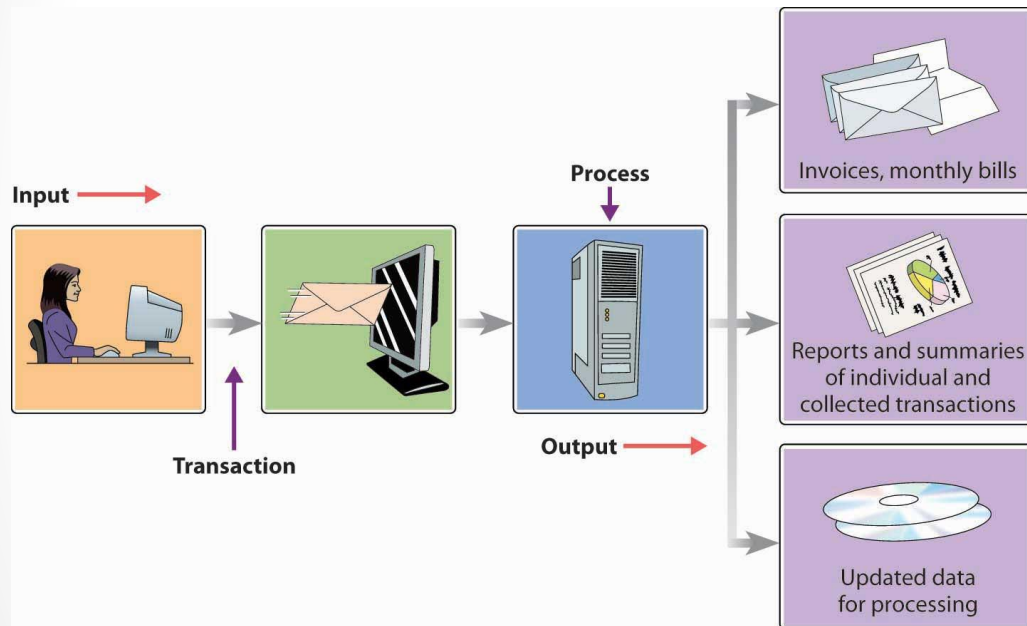
Forward Pricing Proposal Audits

Timekeeping / Labor Audits

Incurred Costs Audits



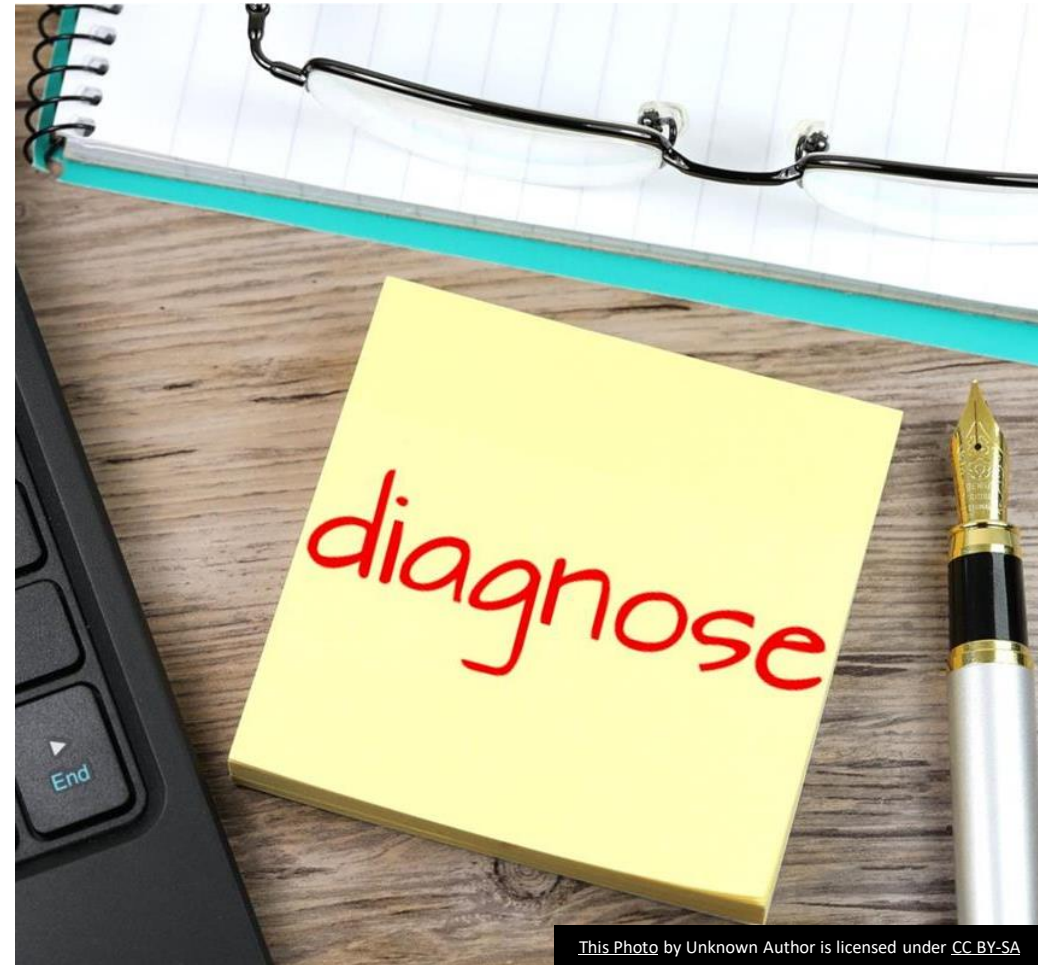
Contract Auditing – Pre-award



- Obtain understanding of the accounting system to appropriately complete the Pre-award Survey of Prospective Contractor Accounting System (SF 1408)
- Express opinion as to whether the **design** of the system is acceptable for contract award
- Contractor completes a checklist asserting it meets SF 1408 criteria and provides narrative describing how it meets each criterion.
- Only involves the evaluation of the system design effectiveness, not the operating effectiveness
 - Contractor walk thru
 - Inquiry of personnel, observation of operations, inspection of relevant documents

Contract Auditing – Post Award

- Objective is to determine if the accounting system is Usually performed at request of contracting officer
 - Follow-up audit to a pre-award survey is recommended
 - Pre-award survey not conducted prior to contract award
- Adequate for accumulating and billing costs on Government contracts
- Includes steps to gain a detailed understanding of the system (e.g., tracing costs billed to source documentation)
 - Encompasses same steps as pre-award survey
 - Additional steps to test billings



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Contract Auditing - Proposals

- Audits requested by contracting officer or administrative contracting officer
- High priority audits – time sensitive
- Contractor provides proposal “walk thru”
 - Explain basis of estimates
 - Provide all certified cost or pricing data
 - Make available access to responsible individuals



Contract Auditing - Proposals

- Direct labor
 - Estimating consistent with accounting
 - Adequate consideration of historical information
 - BOE detail to support labor categories and related hours, rates, and other factors
 - Direct labor rates for salaried individuals consider all hours worked
- Materials
 - Estimating consistent with accounting
 - Adequate consideration
 - historical information, make/buy, discounts/rebates, residual/excess
 - Detailed Bill of Materials
 - Support for commercial Item determinations



Contract Auditing - Proposals

- Other direct costs (ODCs)
 - BOE detail to support other direct costs
 - Estimating consistent with accounting
 - Adequate cost or price analysis of proposed subcontracts
 - Compliant treatment of inter-company transfers
- Indirect costs
 - BOE for indirect expense projections
 - Exclusion of unallowable/unallocable costs
 - Estimating consistent with accounting
 - Includes impact of proposed contract



Contract Auditing – Proposal Concerns

- Contractor direct labor categories do not match RFP categories and no “cross walk” provided
- Contractor labor category qualifications do not match RFP required qualifications
- Subcontractor labor bid using prime contractor rates
- No budgetary data/rationale for indirect rate estimates
- Effect of contract award not considered in budgetary forecasts
- No subcontractor analysis performed or requested
- No basis for ODC estimates
- No consideration of historical information, discounts, rebates, etc.



Contract Auditing – Timekeeping/Labor



Risk and Vulnerability

- Labor costs are usually the most significant contract costs
 - Part or all of base for allocating indirect costs
 - Used to estimate labor for follow-on or similar items
- Not supported by third party documentation
- Contractor personnel have complete control over the documents or devices of original entry
- Responsibility for accuracy is decentralized
- Audit risk almost always significant

Contract Auditing – Timekeeping/Labor

- Floorchecks (low risk) / Comprehensive Labor Audits
 - Unannounced “element of surprise”
 - Usually performed once a year
 - “Ground rules” usually pre-established
- Audit objectives:
 - Compliance with internal controls and procedures to insure reliability of employee time records
 - Physical observations of work areas to determine that employees are at work, performing in the assigned job classifications, and that the time is charged to the appropriate job (Floorcheck)
 - Evaluate the accuracy of the employee labor hour charges to contracts, indirect accounts, or other cost objectives. Requires much more auditor pre interview analysis (Employee interview)



Contract Audit – Timekeeping/Labor

Audit Concerns



- Lack of employee timecard awareness
- Denial of access to contractor employees
- Inaccurate or out of date employee directories
- “Coaching” by contractor escort
- Work at home and/or client site employees
- Destruction of adequate audit trail for labor corrections
- Unrecorded overtime

Contract Auditing – Incurred Costs

- FAR 52.216-7 Allowable Cost and Payment
- Final annual costs and indirect rates
- Adequate final indirect cost rate proposal to be prepared and submitted annually
 - To the Cognizant Federal Agency Official and/or Cognizant Auditor
 - Within the 6-month period following the expiration of each fiscal year
- Final annual indirect cost rates and the appropriate bases to be established in accordance with FAR 42.7
- Proposed final rates based on the contractor's actual cost experience for the fiscal year
- Proposal to be supported with adequate documentation and data
- All cost-type and T&M contracts (except for commercial items/services)

Direct materials	\$10,179
Direct labor	15,176
Applied overhead	7,000
Total cost	\$32,355

Contract Auditing – Incurred Costs

Incurred Cost Submission

- Required to provide basis for retroactive determination of price for flexibly priced contracts
- Schedules and data to be provided dependent upon contractor's accounting system
- Contract clause provides list of schedules for determining form and content of the required submission

Direct materials	\$10,179
Direct labor	15,176
Applied overhead	7,000
Total cost	\$32,355

Contract Auditing – Incurred Costs



Incurred Cost Submission

- Government and contractor to execute a written understanding setting forth the final indirect cost rates specifying
 - Agreed-upon final annual indirect cost rates
 - The allocation bases to which the rates apply
 - The periods for which the rates apply
 - Any specific indirect cost items treated as direct costs in the settlement and the affected contract and/or subcontract
 - Any contracts/subcontracts with advance agreements or special terms and the applicable rates

Contract Auditing – Incurred Costs



Contract Auditing – Incurred Costs

Indirect Costs – Common Questioned Costs

- Compensation – FAR limitations (2023 - \$619,000; 2022 - \$589,000; 2021 - \$568,000;)
- Travel – excess of FAR per diem; lack of purpose
- Legal – reorganizations, protests
- Consultants – lack of work product, rates, agreement
- Severance Pay – excess of 2 wks/yr of service
- Auto Expense – type of vehicle and usage logs
- Industrial Funding Fees – GSA Fees
- Associated Costs - Fringe, O/H, Labor costs, Trade shows
- Employee Welfare – Other Fringe
- Unsupported Costs



Contract Auditing - Guidance

DCAA Website – www.dcaa.mil

- Audit Process Overview
- Directory of Audit Programs
- Contract Audit Manual (CAM)
- Audit Guidance Memorandums (MRDS)
- Federal Acquisition Regulation (FAR)
- FAR Cost Principles Guide (FAR 31.205)
- Defense Federal Acquisition Regulation Supplement (DFARS)
- Cost Accounting Standards (CAS)
- GAO Yellow Book (GAGAS)
- Covid 19 Guidance for Contractors
- Checklists and Tools
 - ICE Model for Incurred Cost Submission
 - Adequacy Checklists (Pre-award accounting system, Proposals, Incurred Cost Submission)



QUESTIONS?