



A Guide to the DCAA Compliant Accounting System

Understanding the SF 1408 Preaward Survey

When a Small Business contracts with the Department of Defense, NASA, or the Department of Homeland Security (and potentially other agencies), they are required to have a [DCAA compliant accounting system](#). While there are many components of a compliant system, just as there many types of [DCAA audits](#), the underlying procedure for assessing a contractor’s system is guided by the [Standard Form \(SF\) 1408](#) (also known as the “Preaward Survey of Prospective Contractor Accounting System”). Here is the content of the SF 1408:

SF 1408 Preaward Survey of Prospective Contractor Accounting System

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 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.)			

The following whitepaper is based directly on the SF 1408, and is meant to be your guide to understanding each of the requirements of a DCAA compliant accounting system.

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IMPORTANT NOTE: THE ENTIRE ACCOUNTING SYSTEM MUST BE CONTROLLED BY WRITTEN POLICIES AND PROCEDURES TO BE COMPLIANT. MOST, IF NOT ALL, OF THE REQUIREMENTS IN THE SF 1408 WILL NEED TO BE DOCUMENTED IN YOUR SPECIFIC POLICIES AND PROCEDURES.

Section 1 – “EXCEPT AS STATED IN SECTION I NARRATIVE, IS THE ACCOUNTING SYSTEM IN ACCORD WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES APPLICABLE IN THE CIRCUMSTANCES?”

- Your accounting system must be in accordance with [Generally Accepted Accounting Principles \(GAAP\)](#). For instance, this means that all accounting will be recorded on an accrual basis (a cash-based accounting system will not meet these requirements).

Section 2 (a) – “(ACCOUNTING SYSTEM PROVIDES FOR): Proper segregation of direct costs from indirect costs.”

The accounting system must have separate accounts for each cost element in significant detail for audit. The direct costs must be collected and separated from indirect costs in the accounting system. The system should provide for invoicing direct costs to the government and properly allocating indirect costs for invoicing to the government (see 2(c)).

Section 2 (b) – “Identification and accumulation of direct costs by contract.”

- Contractors must maintain an adequate job costing system which is integrated with their accounting system. This means that costs must be accumulated by cost element and by project. For every direct cost transaction, a job or project number (or CLIN – see 2i below) must be assigned. Finally, a job cost ledger by project must be maintained by the contractor.

Section 2 (c) – “A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives (contracts).”

- Indirect costs must be grouped into logical categories (i.e. overhead, G&A, fringe, etc.) then allocated to every contract based on a defined methodology. Once defined, the government has specific guidelines, the methodology should be consistently applied. It is important to note that [strategic management of your indirect rates](#) is critical to your bottom line, and to remain competitive in the government contracting industry. Contact ReliAscent to learn how our experts can help.

Section 2 (d) – “Accumulation of costs under general ledger control.”

- The contract by contract accounting of direct and indirect costs being set up must be reconciled at least monthly with the Company's General Ledger.

Section 2 (e) – “A timekeeping system that identifies employees' labor by intermediate or final cost objectives.”

- Contractors must be able to provide labor distribution systems that shows labor allocated to projects and jobs based on the timekeeping system, as well as labor allocated to all indirect activities. This means the labor distribution system must provide labor hours and labor dollars by employee by job and indirect labor accounts. Government auditors rely on specific expectations for timekeeping techniques in order to reduce the risk of labor waste, fraud, and abuse. ReliAscent is partnered with all of the major [DCAA compliant timekeeping software](#) companies, and part of the accounting system install/conversion process involves mapping your timekeeping software back to the General Ledger. To learn more about DCAA compliant timekeeping, contact us today.

Section 2 (f) - A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.

- The source of this distribution must be the timekeeping system. Accordingly, the labor distribution must reconcile to the timekeeping hours, payroll system, job cost ledger and general ledger.

Section 2 (g) - Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account.

- Costs must be accumulated and recorded at least monthly. Further, contractors must accumulate costs on a full cost absorption basis to show not only direct costs but indirect cost allocations as well. To meet this requirement, contractors must be able to present projects on a monthly basis showing full absorption costing, that is, showing total costs incurred on a given project including indirect cost allocations.

Section 2 (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.

- Contractors must comply with the unallowable accounting requirements of [FAR 31.201-6](#). This means the accounting system must track unallowable cost accounts in its accounting system. The system should be documented so that it is clear these costs will not be billed to the government.

Section 2 (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.

- If required by contract terms, contractors may have to track costs by contract line item. This includes charging direct costs to line items and allocating indirect costs to contract line items.

Section 2 (j) - Segregation of preproduction costs from production costs.

Contractors must demonstrate the ability to account for/capture pre-contract costs separately. Pre-contract contract costs are any costs incurred before the effective date of a contract that were required to be incurred to meet schedule for some other contract requirement. In most cases, to be considered allowable, the cost must be subject to an advanced agreement with the government.

Section 3 (a) – “(ACCOUNTING SYSTEM PROVIDES FINANCIAL INFORMATION): Required by contract clauses concerning limitation of cost ([FAR 52.232-20 and 21](#)) or limitation on payments (FAR 52.216-16).”

- Contractors must establish policies that demonstrate compliance with the Limitation of Funds clause. This varies depending on the specifics of the contracts under execution by the contractor. However, in assuming a cost reimbursable environment, the contractor must demonstrate the ability to accumulate direct costs by project, allocation of indirect costs to projects and show current period, year to date and inception to date cost reports with comparisons to funding.

Section 3 (b) - Required to support requests for progress payments.

- Progress payments is a financing technique typically used to accommodate payments under large fixed-price contracts. The key feature of this financing method is contractors can bill up to 80% of contract costs (85% for small businesses) on a monthly basis. Since this is a cost-based billing method, an approved accounting system is required (see [FAR 52.232-16](#)).

Section 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?

- Meeting this last requirement is dependent on compliance with the requirements discussed above.

Section 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.)

- The accounting system does not have to be in operation at the time of a pre-award survey in order to receive a favorable rating. The DCAA Audit Manual suggests: "The audit scope should be limited to obtaining an understanding of the design of the prospective accounting system ... It is not necessary to conduct an in-depth evaluation of the overall accounting system." While it is preferred that a system is already set-up and operating at the time of audit, ReliAscent has passed pre-award surveys using demonstration data.

A nonexistent system will receive an unfavorable rating. By engaging ReliAscent at any time up to the day before the audit, you will join others who have passed their pre-award surveys.

At ReliAscent, the success of our clients and all small business government contractors is our top priority. If you have any questions about DCAA or FAR compliance, or would like to discuss any of our compliant accounting, contract management or outsourced CFO services, please feel free to [contact us](#) or visit our website at any time.

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