



Accounting System Requirements

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

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General Requirement

- Contractor is responsible for establishing and maintaining an acceptable accounting system
- Failure to maintain an acceptable system, as defined by the clause, may result in
 - Withholding of payments
 - Disapproval of the system

Acceptable Accounting System Defined

- System criteria included in DFARS 252.242-7006, *Accounting System Administration*
- An Acceptable Accounting System is a system that complies with the criteria in paragraph (c) of the clause to provide reasonable assurance that—
 - Applicable laws and regulations are complied with;
 - The accounting system and cost data are reliable;
 - Risk of misallocations and mischarges are minimized; and
 - Contract allocations and charges are consistent with billing procedures

Preaward Accounting System Audit

- Evaluates design of Accounting System to determine if acceptable for award
- DCAA or Buying Command will request the contractor complete Accounting System Checklist
- Contractor should be prepared to demonstrate how accounting system satisfies SF 1408 criteria at initial meeting

Post-Award Accounting System Audit

- Evaluates the accounting system for compliance with regulations after contract award
- Looks at the actual operation of the accounting system
- Although an SF 1408 is not required for a postaward accounting system, the accounting system requirements are the same as in the SF 1408

Total Contract Costs

- DFARS requires proper Segregation of direct costs from indirect 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 FAR Part 31 and applicable agency supplements

Direct Cost

- The accounting system should be able to identify and accumulate direct costs by contract
- FAR 2.101 defines Direct Cost as “any cost that is identified specifically with a particular final cost objective.”
- 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

Indirect Cost

- Indirect costs should be accumulated and allocated to intermediate and final cost objectives using logical and consistent methods
- The term “indirect cost” covers a wide variety of cost categories and the costs involved are not all incurred for the same reasons

Indirect Cost

- 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

Indirect Rates

- Examples of indirect cost rates include:
 - Material Overhead
 - Manufacturing Overhead
 - Engineering Overhead
 - Site Overhead
 - General & Administrative (G&A)

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

Allocation Base

- 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

- 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 (TCI 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 31.201

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 costs are often addressed in a contract or request (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

+ Allocation of applicable indirect costs

- Unallowable costs

Total Allowable Government Contract Costs

Accounting for Contract Costs

- The accounting system should provide for the:
 - Accumulation of costs under general ledger control
 - Reconciliation of subsidiary cost ledgers and cost objectives to general ledger
 - Approval and documentation of adjusting entries
 - Interim (at least monthly) determination of costs charged to a contract through routine posting of books of accounts.

Labor System

- An accounting system needs a labor system:
 - A timekeeping system that identifies employees' labor by intermediate or final cost objectives
 - 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
- Employee 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 requires the removal of costs that 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 requires the accounting system to identify costs by contract line item and by units, depending on contract requirements:
 - The accounting system needs 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.

Billings

- Billings should reconcile to the cost accounts for current and cumulative amounts claimed and comply with contract terms
- Billed costs should comply with FAR 52.216-7
 - Costs paid by cash, check, or other form of payment for items/services purchased directly for the contract
 - When not delinquent in paying costs of contract in ordinary course of business, costs incurred but not necessarily paid, for supplies/services purchased directly for the contract and associated financing payments to subcontractors, provided payments made:
 - In accordance with terms/conditions of subcontract invoice
 - Within 30 days of submission of payment request to Government

Billings

- 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

- The system should produce Cost accounting information as required –
 - 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)
 - 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

Cost Accounting Information

- Adequate, reliable data for use in pricing follow-on acquisitions; and
- 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 requires:
 - Management reviews or internal audits of the system to ensure compliance with the Contractor's established policies, procedures, and accounting practices

Other

- A contractor needs to be up to date on its submission of **adequate** incurred cost proposals in accordance with contract terms, if applicable.
- A contractor needs to submit final vouchers within 120 days after settlement of applicable final indirect cost rates for all years as required by FAR 52.216-7(d)(5).

Common Deficiencies

- 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

Common Deficiencies

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.

Questions?