



# Accounting System Requirements

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

# Prior to Contract Award

- Contracting Office or DCMA conducts Preaward Survey to consider responsibility of prospective contractor
- Design of the Accounting System is part of the Preaward Survey (SF 1408 Criteria)
- DCAA requested to evaluate design of Accounting System

# Preaward Accounting System Audit

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

# SF 1408



SF 1408

# Acceptable Accounting System

DFARS 252.242-7006(a)(1) defines an acceptable accounting system as:

“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.”

# Accounting System

DFARS 252.242-7006(a)(2) defines an accounting system as:

“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.

# Total Contract 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



# Direct Cost

DFARS 252.242-7006(c)(3) requires identification and accumulation of direct costs by contract.

- 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

- Again, 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.
- 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

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.

- 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 (G&A)

# Indirect Rates

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

- 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 (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

# Accounting for Contract Costs

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.

# Billings

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

# Billings

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

# 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

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.

# Cost Accounting Information

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



# Other

- A contractor needs to be up to date on its submission of **adequate** final indirect cost rate proposal (incurred cost proposal) in accordance with contract terms, if applicable
- A contractor needs to submit final vouchers within 120 days after settlement of applicable final indirect costs 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

- 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.

# Frequently Asked Questions

How do I request a DCAA audit of my accounting system?

Contractors cannot request the audit. DCAA does not perform audits requested by a contractor. DCAA only performs these audits based on a request from a federal entity based on a need to determine if a contractor is a responsible contractor to award a contract or if needed to determine the acceptability of a contractor's system.

# Frequently Asked Questions

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.

# Questions/Comments

