Accounting Systems and Voucher Reviews for Cost Reimbursement Contracts

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Agenda

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Objectives

To provide an understanding of

• the Federal acquisition requirements for reviewing accounting systems and payments for cost reimbursement contracts, and

• procedures that can be useful when testing agencies’ compliance with these requirements.
Adequacy of Accounting Systems

Contractor's accounting system:

- A system of 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.
Adequacy of Accounting Systems


- **Contractors’ accounting systems** produce critical data that Government agencies can use to negotiate and manage contracts.

- These systems also help agencies protect Federal funds from waste, fraud, and abuse.
Adequacy of Accounting Systems

The Federal Acquisition Regulation (FAR) requires agencies to assess contractors’ accounting systems before awarding high-risk cost-reimbursement contracts or task orders (FAR 16.301-3(a)(3)).

- This requirement is intended to mitigate risk and reduce the Government’s susceptibility to improper payments or other billing errors.
Adequacy of Accounting Systems

To validate the adequacy of a contractor’s accounting system, many Federal agencies request opinions from the Defense Contract Audit Agency (DCAA).

➤ To determine whether a contractor’s accounting system is adequate for Federal awards, DCAA relies on audits performed no more than 3 years prior to a contract award.

➤ This 3-year timeframe suggests that it is a best practice for agencies to review contractors’ accounting systems on a regular basis.
Adequacy of Accounting Systems

During an on-going OIG audit, we found that an agency awarded a master contract based on a cost accounting adequacy determination that was over 3 years old. Although this is allowed, it is not a best practice.

➢ The contract file contained a letter from DCAA stating that because of the lack of a current audit, DCAA could not provide an opinion on the adequacy of the contractor’s cost accounting system.

➢ The agency awarded the contractor three task orders totaling $7.6 million—5 years after DCAA issued its opinion on the accounting system.
Adequacy of Accounting Systems

The agency put itself at risk for paying unallowable, unallocable, and unreasonable costs. For example,

➢ In March 2013 and February 2017, the contractor reached two settlements with the Department of Justice on the behalf of other Federal agencies due to timecard fraud and improperly billed overhead rates.

➢ The March 2013 settlement required the contractor to improve its accounting system to detect and deter timecard fraud.
Adequacy of Accounting Systems

If a contractor has no current audit available, COs may turn to other options to ensure that they award contractors with adequate accounting systems and reduce the risk of improper payments.

- FAR 15.404-1 references several risk mitigation techniques, including
  - Requesting field pricing assistance,
  - Requesting survey or accounting system reviews, and
  - Strengthening invoice review procedures and oversight.
Invoice Reviews
Invoice Reviews

- The Government makes payments to a contractor as work progresses in amounts determined to be allowable by the contracting officer (FAR 31.216-7, Payment Clause).

- The FAR’s Payment Clause also states that the contractor may submit to an authorized representative of the contracting officer, in form and reasonable detail as the representative requires, an invoice or voucher supported by a statement of the claimed allowable costs (FAR 31.216-7).
Invoice Reviews

In order to determine the allowability of costs, the CO or the CO’s representative must:

- evaluate supporting information for both
  - direct costs such as direct labor and materials, and
  - allocated indirect costs such as overhead and general and administrative costs.
Invoice Reviews

Direct Costs

Support for direct labor can include timesheets and payroll records.

- Supplier invoices can support materials charges.
- Verifications can occur through:
  - DCAA audits,
  - other audits, or
  - periodic support attached to contractors’ invoices.
Invoice Reviews

Indirect Costs

FAR 31.216-7 and FAR 42.7 contain specific instructions for

- reviewing indirect costs on interim vouchers, and
- establishing final indirect rates.
Invoice Reviews

- **Allowable indirect costs** shall be obtained by applying indirect cost rates established in accordance with FAR 31.216-7 (d).

- A single agency shall be responsible for establishing **final indirect cost rates** for each business unit. These rates shall be binding on all agencies (FAR 42.7).

- **Billing rates and final indirect cost rates** shall be used to reimburse indirect costs under **cost reimbursement contracts**.
Invoice Reviews: Billing Rates on Interim Invoices

The contracting officer, Contracting Administrative Official (CAO) or auditor responsible for establishing the final indirect cost rates shall also be responsible for determining the billing rate.

- The CO, CAO, or auditor shall
  - establish billing rates on the basis of a recent review, previous rate audits, or experience, and
  - ensure that the billing rates are as close as possible to the final indirect rates anticipated for the fiscal period as adjusted for any unallowable costs (includes use of decrement factors).
Invoice Reviews: Costs

Usually, DCAA is the responsible Government audit agency.

- However, DCAA may decline requests for services on a case-by-case basis (FAR 42.101).

- Contracting officers may request audit services directly from a responsible audit agency listed in the Directory of Federal Contract Audit Offices.
The FAR’s Payment Clause addresses two areas:

1. Interim reimbursement of costs (vouchers), and
2. Determination of final indirect rates.

Interim and final costs must be allowable. The CO is responsible for deciding how to ensure costs are allowable and whether field (audit/CAO) assistance is needed.

For verification of interim vouchers, COs may:

- Request audit services from DCAA or the COA,
- Request audit services from an CPA firm, or
- Establish internal procedures to make a determination.

The invoice reviews:

Costs
Invoice Reviews: Compliance and Verification of Interim Vouchers

COs’ methods and extent of compliance verification for approving payments differs significantly within and among agencies.

- Many agencies issue policies and have detailed procedures on the steps to take to verify or determine whether costs are allowable and reimbursable.

- Other agencies rely on a contracting officer’s representative (COR), who works on or with the program. Frequently, the COR decides on specific steps to perform.
Invoice Reviews: Compliance and Verification of Interim Vouchers

For DOD, DCAA usually reviews vouchers. DCAA uses sampling, though its sampling method has varied and changed in recent years.

- DOT does not use DCAA for interim voucher reviews.
- Other agencies also may not use DCAA.
- We have found that the use of supporting records varies. Documented reviews of invoices frequently are not included in the either contract or payment files.
Invoice Reviews:
Internal Control Weaknesses in Interim Voucher Reviews

During recent audits, we have identified weaknesses in interim voucher reviews.

- As previously described, a contractor was awarded multiple cost reimbursement task orders over 5 years. However, the COs did not request audits of vouchers or incurred costs (final rates), or determine whether the accounting and billing systems were adequate.
  - The status of the accounting system was not determined prior to contract award and punitive actions were taken by DOJ against the contractor due to billing irregularities and fraudulent practices.
    - The contractor billed higher overhead rates instead of lower on-site overhead rates, and also billed hours in excess of those documented in employee timesheets.
Invoice Reviews:
Internal Control Weaknesses in Interim Voucher Reviews

➢ The buying/contracting office did not determine what indirect rates were being billed.
  ▪ This determination could have been easily done since the contractor and the Defense Contract Management Agency had established provisional billing rates for billing agencies.

➢ The CO did require timesheets to support direct labor charges. However, although we examined only one invoice, we found that the hours billed on that invoice exceeded the hours on the timesheets.

➢ DOT was reimbursed for the over billing.
Invoice Reviews: Internal Control Weaknesses in Interim Voucher Reviews

- Other invoice problems that occurred:
  - Subcontractor invoices were not received or verified.
  - Inadequate reviews of interim invoices were exacerbated in the absence of incurred cost audits.
  - Unclear basis for the CO’s determination that the costs for the task orders were allowable.
  - Hotline complaints about billing problems.
Invoice Reviews:
Audits of Direct Costs and Final Indirect Rates

When a contractor has at least one DOD cost type contract that incurred costs during a fiscal year, DCAA will verify incurred costs/final rates.

➢ When a contractor has no DOD contracts, civilian agencies have a number of compliance options available. They may
  ▪ ask DCAA to perform an audit of the contractor,
  ▪ do their own review of the contractor, or
  ▪ contract with CPA firm to conduct a review.
Invoice Reviews: Audits of Direct Costs and Final Indirect Rates

DCAA has changed its approach to incurred cost audits.

- In the past, DCAA performed reviews of both large and small contractors.
  - It generally performed attestation audits of large contractors, but performed more limited reviews of small contractors.
  - However, GAO reviewed and reported that DCAA’s limited reviews did not meet the auditing standards and that the work should not be referred to as “audits” in these instances.

- DCAA changed its approach for small contractors to sampling. As a result, many firms with DOD contracts have their rates accepted, with cursory reviews in some instances.
Invoice Reviews:
Audits of Direct Costs and Indirect Rates - Key Points

➤ In most instances, DOT Operating Administrations do not obtain incurred cost audits, so it is important for them to conduct detailed interim invoice reviews.

➤ DCAA does not conduct incurred cost audits for civilian agencies without specific requests.

➤ In multiple reviews, we found that agencies frequently do not complying with Transportation Acquisition Management (TAM) guidance.
Invoice Reviews: Audits of Interim Vouchers

DOT’s TAM calls for agencies to perform in-depth reviews of all invoices and vouchers submitted by contractors (TAM 1232.7).

- The extent of the review depends on the terms and conditions of the contract. Tasks may include:
  - determining whether billed costs are allowable and allocable per FAR 31.2, and
  - obtaining the recommendation of a Government technical representative, such as an inspector or auditor, regarding the payment of a contractor’s voucher.
Invoice Reviews:
Audits of Incurred Costs and Final Indirect Rates

- DOT recognizes that periodic audits of incurred costs are the preferred way to assist COs.
- If a CO decides not to obtain an audit or audit services are not available from the responsible agency, the CO shall document
  - why an audit was not obtained,
  - the extent of the analysis—such as desk analysis, comparisons of proposed to actual rates, examination of claimed costs—performed in lieu of an audit, and
  - other factors (TAM 1242.7).
What Federal Agencies Can Do
Cost Reimbursement Contracts:

What Federal Agencies Can Do

To avoid billing errors and overpayments, comply with the FAR before awarding a cost reimbursement contract.

Because DCAA is conducting fewer incurred cost audits, use other methods to ensure that costs are allowable. For example, before awarding a cost reimbursement contract, To avoid billing errors and overpayments, comply with the FAR.

- COs can check for issues with accounting systems and billing rates.
- Contract with a CPA firm to conduct incurred cost audits.
- When reviewing interim contractor vouchers, also review invoices and timesheets to verify cost allowability and provisional billing.
- Check for issues with accounting systems and billing, and alleged fraud and potential wrongdoing.
What You Can Do
Cost Reimbursement Contracts: What You Can Do

You can incorporate reviews of accounting system adequacy and interim vouchers into your programmatic contract and grant management reviews.

➢ These procedures are also applicable to reviews of contracting commands and activities and multiple award programs.