

Will your accounting system pass muster?

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So you have been notified of a prospective contract award, the first of this size for your company. However, the contracting officer has said that prior to definitizing the contract, he would like a preaward audit performed of your company and its [accounting system](#). Suddenly a panic overtakes you as you look down at the various Post-It notes that constitute your accounting system and wonder if this will pass muster. Can this impact the potential award of this contract? The answer is yes, an award may be delayed or even not awarded at all if your accounting system does not meet certain criteria set forth by the government. This article will walk you through this process and guide you to a successful audit.

The first misconception that requires clearing-up is that there is no such thing as "DCAA approved" [accounting software](#). If any software product is making this claim, I would not purchase the product. DCAA does not approve accounting software products. What DCAA does approve for a contractor is how they utilize the product and the various processes it employs.

There are certain software products that are widely used and recognized in the government contracting industry; however, the purchase of these products does not ensure passage of a preaward audit. Any software product, whether recognized in the industry or not, will be able to pass such an audit by following the processes detailed in this article.

Because of the nature of the types of contracts that are awarded (cost reimbursable, time and materials, firm fixed price), the government contracting industry imposes unique burdens on a [contractor's accounting system](#). It must employ the following processes before it will pass an audit:

1. Segregate direct costs from indirect costs. A direct cost is any cost that can be identified with a final cost objective (i.e. a contract). Indirect costs cannot be specifically identified with

one final cost objective, but benefit multiple cost objectives. Thus, your chart of accounts should be set up to address this distinction.

2. Accumulate and segregate direct costs by contract and by contract line item. It is not enough to segregate costs by direct and indirect. The direct costs must be further segregated on a contract by contract basis and in some instances, on a contract line item basis.

3. A logical and consistent method for the allocation of indirect costs. Indirect costs need to be grouped into logical categories (i.e. fringe, overhead, G&A, etc.) then allocated to every contract based on a defined methodology. An example of this would be to allocate overhead on the basis of direct contract labor dollars. Once defined, though, the methodology should be consistently applied.

4. Costs must be accumulated 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.

5. A timekeeping system that identifies labor by cost objective and allocates this time properly. This is where many contractors systems falter. All employees' time, whether direct or indirect, must be accounted for daily, by the work activity being performed. If the charges are to indirect, they must be allocated in a logical and consistent manner.

6. Interim determination of costs. This means that the books should be closed at least monthly to have a proper accounting of contract costs.

7. Segregation of unallowable costs. FAR 31.205 details the various categories of unallowable expenses. Contractors must ensure that unallowable costs are being properly segregated in the accounting system from allowable costs.

As you can tell, doing [business](#) with the federal government is a unique animal. If no one in your organization has been through this process before or you are unaware of these requirements, you should consider retaining the services of a consultant to assist you with this process. By following these guidelines, your contract award should not be delayed and you should pass your audit with flying colors!

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