



DoD SBIR/STTR Training

ACCOUNTING SYSTEM DESIGN

February 16, 2016



What is an Acceptable Accounting System?

For SBIR/STTR Phase II contracts a small business must have an accounting system acceptable for government contracting purposes, as determined by a Defense Contract Audit Agency (DCAA) audit and Contracting Officer determination.

Acceptable accounting system

DFARS 252.242.7006(a)(1) defines an acceptable accounting system as a system that must provide reasonable assurance that it is:

- ✔ Compliant with that applicable laws and regulations
- ✔ The accounting system and its cost data must be reliable
- ✔ Risk of misallocations and mischarges must be minimized
- ✔ Contract allocations and charges must be consistent with billing procedures

The design of the accounting system is part of the pre-award survey (form SF 1408).

The small business should be prepared to demonstrate how their accounting system satisfies SF 1408 criteria.



Evaluation criteria

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Segregation of Cost

DFARS 252.242-7006 (c)(2) requires:

- A proper separation 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 that are allowable pursuant to FAR Part 31 and applicable agency supplements**



Direct costs are 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.

Direct costs of the contract shall be charged directly to the contract.

No final cost objective should have any cost that has been included in an indirect cost pool allocated to it as a direct cost.

Indirect costs are 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.

DFARS 252.242-7006 (c)(4) requires "A logical and consistent method for 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.

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.



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Accumulation of Costs Under General Ledger Control

All costs should be accumulated under the small businesses general ledger.



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Time Keeping System

The Accounting System should provide a timekeeping system that identifies employees' labor by intermediate or final cost objectives.

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 their timesheet on a daily basis and **include all hours worked** including uncompensated overtime.

Labor cost distribution records should be **reconcilable to payroll records** and labor distribution records should **trace to and from** the job cost ledger and general ledger accounts.



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Charging Direct and Indirect Labor Correctly

The Accounting System should provide for a labor distribution system that charges Direct and Indirect labor to the appropriate cost objectives.



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Interim Determination of Costs

The Accounting System should provide for at least a monthly determination of costs charged to a contract through routine posting of books of account.



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Exclusion of Unallowable Costs

The Accounting System should exclude 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.

Unallowable costs need to be **identified and excluded** from any billings, claims, and proposals applicable to a Government contract.

Contractors need **written policies and procedures** to identify and exclude unallowable costs.



Allowability (FAR 31.201-2)

A cost is allowable only when the cost complies with all of the following requirements:

1. Reasonable
2. Allocability
3. Terms of the Contract
4. Applicable Cost Accounting Standards
5. Any Limitations Set forth in the entire Subpart 31.201

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

Reasonableness (FAR 31.201-3)

A cost is considered to be reasonable if

1. In its nature, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business
2. It is the contractor's responsibility to establish that each cost is reasonable

Contract term

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



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Identification of Costs by Line Item & Units

The Accounting System should provide for the identification of costs by contract line item and by units (as if each unit or line item were separate contract) if required by the proposed contract.

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.



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Segregation of Pre-Production and Production Costs

The Accounting System should provide for the segregation of pre-production and production costs.

Contractor's proposals should identify **pre-production, start-up, and other nonrecurring costs**, including such elements as pre-production engineering, special tooling, special plant rearrangement, training programs, initial rework or spoilage, and pilot runs.



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Financial Information Concerning Limitation of Cost or Limitation on Payments

The Accounting System should provide financial information as required by contract clauses concerning Limitation of Cost (FAR 52.232-20 and 21) or Limitation on Payments (Far 52.216-16).

DFARS 252.242-7006 (c) requires cost accounting information, as required—(15)

(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);

(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 expenditures against contract limitations on price or cost



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Financial Information for Progress Payments

The Accounting System should provide financial information required to support requests for Progress Payments.

Progress payments occur when **a certain percentage of progress on a fixed price contract is completed**. For example, a contractor may invoice once 25% percent of the project is complete and again at 50% complete.



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Reliable Data for Pricing Follow-On Acquisitions

The Accounting System should be designed, and the records maintained, in such a manner that adequate, reliable data are developed for use in pricing follow-on acquisitions.

The accounting system should be able to **demonstrate where your costs incurred come from.**

The system should be able to **reliably allow the costs to be broken down** to see how many hours were billed, who billed those hours, when those hours were accrued, and to what project/contract they were charged to.



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

Consequences of Not Having an Appropriate Account System

- Award(s) can or will be delayed
- Payments can be delayed
- Award can be canceled or terminated



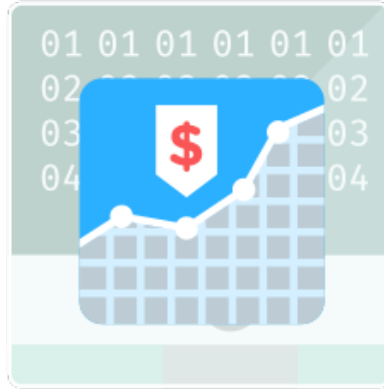
Additional Resources

+ Accounting System Requirements

This DCAA presentation provides additional information about the requirements that need to be fulfilled by an acceptable accounting system.

+ DCAA Audit Process Overview

This page provides small businesses an overview of the types of audits DCAA conducts and resources to help prepare for them. This page also has the contact information of the DCAA Small Business Focal Point, who can help provide additional assistance and answer any questions.



Congratulations!

You've finished the lesson on accounting system