Is Your Accounting System Adequate for Government Contracts?
By Glenda A. Tysinger

The government marketplace is more complex because of the multitude of compliance requirements. In addition to GAAP and IRS accounting regulations, the U.S. government requires strict adherence to a massive number of additional requirements as defined by CAS, FAR and DCAA for all government contracts. Therefore, it is essential to establish a comprehensive accounting and compliance system that integrates financial accounting with government contract management.

Prior to contract award, the cognizant contract administration office will generally conduct a preaward audit. Normally there are two areas of concern: (1) the contractor's capability to perform the contract; and (2) the adequacy of the accounting system to accumulate the type of cost information required by the contract. If the accounting system is not meet the requirements for accumulating costs under a prospective government contract, the contract may not be awarded.

The proper segregation of direct costs from indirect costs is a fundamental part of the accounting system for government contracting. After the identification of the criteria established, it must be applied consistently. Direct costs are any costs identified specifically with a specific cost objective such as a contract or purchase order (FAR 31.202). Direct costs include labor, travel, materials, etc. specifically identified with a contract. If it is not feasible to identify a cost specifically to a contract when the cost is immaterial or is identified with more than one cost objective, then the costs would be treated as an indirect cost (FAR 31.203).

Indirect costs include facility costs, rent, employee benefits, etc. These types of costs are normally included in an overhead, general and administrative (G&A) or fringe pool and allocated to contracts on an equitable basis.

The identification and accumulation of direct costs by contract is a vital part of the accounting system. It is generally referred to as a job cost accounting system, which is a subsidiary ledger where costs are accumulated by each cost objective with the appropriate allowable indirect expenses allocation. The job cost accounting system must reconcile to the general ledger. These reports should be produced at least monthly.

The logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives based upon relative benefits received is required by FAR 31-201-4, "Determining allocability," and 31-203, "Indirect costs." This means that if seemingly similar costs are treated as both direct costs and indirect costs, the rationale behind the cost determination must be validated. For example, if a contractor supplies administrative support at a client site and the contractor has an administrative group for general activities supporting all contracts activities, which is treated as an indirect cost and allocated to all contracts, the contractor may charge the cost of the client site administrative support cost directly to the particular contract requiring them. In this example, the contractor may allocate a portion of the remaining cost of the general administrative staff to the same contract only if the separate classes can be shown to serve different purposes consistently (that is, costs charged directly to the contract are only costs of the contract-required administrative staff at a fixed post, and no costs of the that staff are ever included in the indirect cost pool.

The accounting system should include a timekeeping system that identifies employees' labor indirect costs and/or direct costs to a particular contract. There should be an established company procedure for timecard preparation which can be manually or electronically prepared. DCAA recommended timekeeping policy includes:

1. The supervisor should approve and cosign all timecards.
2. The supervisor is prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on authorized leave or on travel. Upon the return, the employee should turn in a time sheet and attach the supervisor prepared one.
3. The guidance should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors.
4. The company policy should state that the accurate and complete preparation of timecards is a part of the employee's job. Careless or improper preparation may lead to disciplinary actions under company policies, as well as applicable Federal statues.

Once the employee's time is segregated as described previously, the costs must be allocated to the appropriate cost objectives, whether direct or indirect.

The FAR Part 31 identifies some costs as expressly unallowable and requires that they are excluded from proposals and billings. Examples of those costs are:

1. Bad debts
2. Contingencies
3. Contributions or donations
4. Entertainment
5. Mutually agreed upon between the contractor and the contracting officer even if these costs are legitimate business expenses, they will not be accepted by the U.S. government as allowable contract costs. The contracting officers are authorized to assess a penalty if a contractor claims an expressly unallowable cost in either the final indirect cost rate proposal or the final statement of costs incurred or estimated to be incurred under a fixed price incentive contract.

If you intend to enter the government contracting market place, prepare to have the proper Accounting System in place for review prior to contract award.

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