



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 730.5.35

July 26, 2013
13-PPD-013(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA;
DIRECTOR, FIELD DETACHMENT, DCAA,
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Alert on Testing to Payment – Testing Contractor Compliance with Certain Sections of FAR 52.216-7, Allowable Cost and Payment Clause during Incurred Cost Audits

The audit team is responsible for testing the contractor's compliance with FAR 52.216-7(b)(1), Allowable Cost and Payment clause – (Reimbursing Costs), during incurred cost audits. FAR 52.216-7(b)(1) provides that allowable costs only should be reimbursed when paid in the ordinary course of business (ordinarily within 30 days of the request for payment to the Government). The audit team should question claimed costs that the contractor never paid and consider if this is a fraud risk indicator.

Planning Considerations

- **Prior Testing is Not Available** – The audit team will need to perform testing to payment in the current audit if we have not performed real-time testing of transactions back to payment during the year under audit.
- **Prior Testing is Available** – The audit team should consider the results of testing to payments performed during the incurred cost fiscal year in other assignments (e.g., paid voucher, accounting/billing system). The audit team should document in the risk assessments the specific audit work previously performed and determine if the testing is sufficient to support the conclusions in the current incurred cost audit related to testing for payment. If prior testing is not sufficient, the audit team should determine the appropriate testing to complete in the current audit.
- **Reliability of Computer-Based Data** – If the audit team has already established the reliability of computer-based data relative to testing to payment (e.g., check register, bank statement, online bank transaction history, accounts payable aging, etc.), the team may limit current testing to verification of these reports.

Testing Considerations

The audit team should design appropriate tests to ensure the contractor's compliance with FAR 52.216-7(b)(1) based on their understanding of the contractor environment, internal controls, the contractor's payment process and the identified risk in that area. The audit team should perform substantive testing.

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Substantive Testing of Payment

Based on the assessed risks, the audit team may perform either of the following procedures on all costs, except labor:

- If the risk of non-payment is low, based on your planning considerations noted above, perform a judgmental selection or sample of all payments (i.e., all non-labor expense accounts) to source documents (e.g., cancelled checks, electronic funds transfers, bank statements, or other evidence of payment). Then perform separate samples to test individual accounts for allowability.
- If the risk of non-payment is high, establish payment as a criterion when testing for allowability as part of transaction testing.

When testing labor, at a minimum, the auditor should:

- Reconcile payroll totals (dollar values and hours) with totals of related labor cost distribution records;
- Evaluate the Schedule L, Reconciliation of Total Payroll per IRS Form 941 to Total Labor costs, in the incurred cost submission; and
- Test quarterly taxes to evidence of payment (i.e., contractor bank statement, electronic fund transfers, or third party payroll processor records).

Other Information

- In most cases, the audit report opinion will need to be qualified if testing of payment is insufficient for the incurred cost year (e.g., contractor records are not available due to the age of the assertion).
- The incurred cost audit program is in the process of being revised to add audit procedures that address testing to payment.

Further Assistance

FAO personnel should direct questions regarding this memorandum to their regional offices, and regional personnel should direct any questions to Policy Programs Division at (703) 767-2270 or e-mail at DCAA-PPD@dcaa.mil.

/Signed/
Donald J. McKenzie
Assistant Director
Policy and Plans

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FREQUENTLY ASKED QUESTIONS

Question 1: Can I test only part of my sample for allowability to payment?

Answer: No. If you choose to establish payment as one of the criterion you will test during a sample for allowability, you must apply that criterion to all sample items. However, you may choose to test the entire universe of expense transactions for payment and then pull separate samples to test for allowability, provided the risk of non-payment is low.

Question 2: If I have requested an assist audit do I need to test for payment?

Answer: Yes. The assist audit establishes the amount the subcontractor should be paid, not the amount the prime contractor actually paid the subcontractor.

Question 3: If the current accounts payable aging report shows that the contractor has no outstanding liabilities of 30 days, do I have to test to payment?

Answer: Yes. The audit teams cannot simply rely on the aging of accounts payable. First, the team would have to establish the reliability of the aging report. In addition, Generally Accepted Accounting Principles allow for the write off of liabilities. Therefore, while the contractor's financial data may support reduced risk; the audit team still must do some testing to payment based on the risk.

Question 4: If the FAO has performed testing to payment as part of its paid voucher reviews, does testing to payment still need to be done in the incurred cost audit?

Answer: It depends. The audit team must document the previously performed testing and their professional judgment as to whether or not the previous testing is sufficient and appropriate to support a conclusion that the contractor is complying with FAR 52.216-7(b)(1).

Question 5: If the testing to payment discloses that the contractor has not paid certain expenses, should I question the cost?

Answer: Yes. The audit team should question the cost based on the FAR 52.216-7(b)(1) requirement that to be reimbursable the contractor should have paid its claimed expense in the ordinary course of business. While the audit team should question the cost in the incurred cost report, they also must determine if the contractor actually billed the Government and was paid by the Government. If the Government has paid the contractor, the audit team needs to coordinate with the contracting officer to recover the money even before issuing their report (e.g., DCAA Form 1s). The team also must use their professional judgment in determining how to handle this fraud risk indicator.

Question 6: If the testing to payment discloses that the contractor has paid expenses but not in accordance with its procedures (e.g., normal course of business (30 days)), should I question the cost?

Answer: No. The audit team should not question the cost since the contractor has already paid the expenses. However, the team should report the non-compliance and determine why the contractor is not paying its expense in the normal course of business as required by FAR 52.216-7(b)(1). In addition, the team should take action to ensure the contractor's current billings are in compliance with FAR 52.216-7(b)(1) and DFARS 252.242-7006(c)(16).