

Contract Formation

Activity 24: Accounting and Estimating Systems

Procedures for examining the suitability of a contractor's accounting and estimating systems.

Related Flow Charts: [Flow Chart 24](#)

Part A: Accounting Systems

Tasks	FAR Reference(s)	Additional Information
<p>1. Determine the adequacy and suitability of a firm's accounting system and practices.</p>	<p>FAR 31.201-6 Accounting for unallowable costs [contracts with commercial organizations].</p>	<p>The objective of the accounting system review is to determine the adequacy and suitability of a firm's accounting system and practices for accumulating costs under a prospective or existing government contract. There are three sources of accounting principles and standards applicable to contractor accounting systems. In order of precedence they are:</p> <ul style="list-style-type: none"> • Cost Accounting Standards (CAS) promulgated by the Cost Accounting Standards Board; • Federal Acquisition Regulation (FAR); and • Generally Accepted Accounting Principles (GAAP). <p>When contractor accounting practices are inconsistent with these applicable requirements, costs resulting from such inconsistent practices must not be allowed in excess of the amount that would have resulted using consistent practices.</p>
<p>2. Request the contractor to complete the Standard Form (SF) 1408.</p>	<p>FAR 9.106-4 Reports [preaward surveys].</p>	<p>Request a preaward survey when the information on hand or readily available is not sufficient to make a determination on contractor responsibility. A preaward survey should not be requested for a:</p> <ul style="list-style-type: none"> • Commercial item acquisition, or • Fixed-price contract action at or below the simplified acquisition threshold (SAT).

Tasks	FAR Reference(s)	Additional Information
<p>3. Determine whether to request an accounting system review.</p>	<p>FAR 9.105-1 Obtaining information [responsible prospective contractors].</p> <p>FAR 15.404-2 Data to support proposal analysis.</p> <p>FAR 16.205-3(b) Limitations [fixed-price contracts with prospective price redetermination].</p> <p>FAR 16.206-3(b) Limitations [fixed-ceiling-price contract with retroactive price redetermination].</p> <p>FAR 16.301-3(a) Limitations [cost-reimbursement contracts].</p> <p>FAR 16.403-1(c) Limitations [fixed-price incentive (firm target) contracts].</p> <p>FAR 16.403-2(c) Limitations [fixed-price incentive (successive targets) contracts].</p> <p>FAR 32.503-3 Initiation of progress payments and review of accounting system [postaward matters].</p>	<p>An accounting system review may be requested as part of a preaward survey, cost audit, or field pricing support. When determining the need for an accounting system review, consider the following:</p> <ul style="list-style-type: none"> • A firm must have an adequate accounting system before: <ul style="list-style-type: none"> ○ It can be awarded a: <ul style="list-style-type: none"> ▪ Fixed-price contract with prospective price redetermination; ▪ Fixed-ceiling -price contracts with retroactive price redetermination; ▪ Fixed-price incentive (firm target) contract; ▪ Fixed-price incentive (successive targets); or ▪ Cost-reimbursement contract. ○ Initiation of progress payments. <p>Do not request a review if adequate accounting system information is available from a recent preaward survey or cost audit. Do not use a report for a purpose other than the purpose for which it was intended.</p>
<p>4. Review the auditor's report to determine if the accounting system is in accordance with GAAP.</p>	<p>FAR 31.201-6 Accounting for unallowable costs [contracts with commercial organizations].</p>	<p>The contractor accounting system must be consistent with the GAAP is responsible for the accounting principles, standards and procedures that companies use to compile their financial statements. GAAP is a combination of authoritative standards (set by policy boards) and the commonly accepted ways of recording and reporting accounting information.</p>

Tasks	FAR Reference(s)	Additional Information
<p>5. Prepare an initial position on the adequacy of the firm's cost accounting system based on the auditor's report.</p>	<p>FAR 30.202-6 Responsibilities [CAS program requirements]. FAR 30.202-7 Determinations [CAS program requirements].</p>	<p>Review the available information and ask any questions necessary to assure understanding of the position taken by the auditor. Consider:</p> <ul style="list-style-type: none"> • Facts found during the accounting system review; • Missing or insufficiently documented findings; • Apparent fallacies (quantitative or logical); and • Inconsistencies between the findings and other available information. <p>Based on the available information, establish an initial judgment on the adequacy of the system. That position will depend on the reason for the review. Potential initial positions include:</p> <ul style="list-style-type: none"> • The proposal is not adequate for negotiation; • The contractor is not responsible or that the accounting system is not acceptable for the proposed contract type; and • The system is not adequate to support progress payments.
<p>6. Discuss the accounting system review with the firm.</p>	<p>FAR 15.303(c) Responsibilities [source selection]. FAR 15.404-2(a)(5) Field pricing assistance [data to support proposal analysis]. FAR 15.404-2(c)(1) Audit assistance for prime contracts or subcontracts [data to support proposal analysis].</p>	<p>If the accounting system review uncovers weaknesses or deficiencies, consider discussing them with the contractor prior to making a decision on adequacy.</p>
<p>7. Make a finding on system adequacy.</p>	<p>FAR 15.404-2(c)(4) Audit assistance for prime contracts or subcontracts [data to support proposal analysis]. FAR 15.404-2(d) Deficient proposals [data to support proposal analysis].</p>	<p>The accounting system may be:</p> <ul style="list-style-type: none"> • Adequate; • Adequate with exceptions covered by a corrective action plan; or

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		<ul style="list-style-type: none"> • Inadequate. <p>If the accounting system is deemed adequate with exceptions, the contractor must take appropriate action to correct the deficiencies or weakness. As a result of this finding:</p> <ul style="list-style-type: none"> • The contracting officer potentially cannot rely exclusively on available price information to determine price reasonableness; • The firm’s accounting system may not be able to support or administrate a cost-reimbursement contract until their corrective action plan resolves any outstanding weakness; • The contracting officer may consider withholding award until the contractor agrees to remedy any identified deficiencies; or • The contracting officer may refuse to make progress payments based on cost until the accounting system is completely adequate. <p>If the firm’s accounting system is not adequate, the contracting officer can adhere to any of the following recommendations:</p> <ul style="list-style-type: none"> • Use price analysis exclusively to determine price reasonableness; • Eliminate the firm from consideration; • Withhold the award until the deficiencies are remedy; • Use a different contract type; • Refuse to initiate progress payments until the accounting system is made acceptable; • Reduce progress payments until the accounting system is made acceptable; or • Use performance-based payments instead of progress payments based on cost.

Tasks	FAR Reference(s)	Additional Information
8. Notify the contractor of deficiencies and the accounting system review recommendations.	<p>FAR 15.404-2(c)(1)(i) Audit assistance for prime contracts or subcontracts [data to support proposal analysis].</p> <p>FAR 15.404-2(d) Deficient proposals [data to support proposal analysis].</p>	<p>The auditor will promptly notify both the contractor and the procurement official of the deficiencies, and will usually identify recommendations for correcting the deficiencies. The auditor will not develop the new system because this is the contractor's responsibility.</p>
9. Take measures to protect the Government's interest when an accounting system is inadequate.	<p>General Practice.</p>	<p>If the firm's accounting system is not adequate, take appropriate action to protect the Government's interests.</p> <ul style="list-style-type: none"> • If the review was requested to determine if the cost accounting system was adequate to support cost analysis, use price analysis exclusively to determine price reasonableness. If the price cannot be determined reasonable using price analysis consider other sources or consult management for other alternatives. • Alternatives to awarding a contract include: <ul style="list-style-type: none"> ○ Eliminating the firm from consideration because it is not responsible; ○ Withholding award until the contractor agrees to remedy any identified deficiencies; or ○ Using a different contract type. • Alternatives to progress payments based on cost include: <ul style="list-style-type: none"> ○ Refusing to initiate progress payments based on cost until the accounting system is made acceptable; ○ If the Government is already making progress payments based on cost, reducing or suspending progress payments until the accounting system is made acceptable; or ○ Using performance-based payments instead of progress payments based on cost.

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<p>10. Discuss and initiate the recommended corrective action plan.</p>	<p>FAR 15.404-2(c)(1) Audit assistance for prime contracts or subcontracts [data to support proposal analysis].</p> <p>FAR 15.404-2(d) Deficient proposals [data to support proposal analysis].</p>	<p>When a preaward survey discloses previous unsatisfactory performance, the surveying activity must specify the extent to which the prospective contractor plans to take, or has taken, corrective action. Communications may be either oral or written. Request the cognizant auditor and/or administrative contracting officer (ACO) to participate in the communication. During these communications:</p> <ul style="list-style-type: none"> • Review each identified deficiency. <ul style="list-style-type: none"> ○ Describe the position on each deficiency; ○ Provide relevant facts relating to any disagreement; and ○ Describe any plans for correcting deficiencies. • Reach agreement with the firm on resolving deficiencies (if possible). • Summarize differences relating to the deficiencies.
<p>11. Request a follow-up audit of the accounting system.</p>	<p>FAR 15.404-2(d) Deficient proposals [data to support proposal analysis].</p>	<p>Once the required corrective actions have been taken by the contractor to correct the deficiencies, if requested by the contracting officer, auditors will perform a follow-up audit of the revised system and/or corrected deficiencies.</p>

Part B: Estimating Systems

Tasks	FAR Reference(s)	Additional Information
<p>1. Identify conditions that may indicate estimating system deficiencies.</p>	<p>General Practice.</p>	<p>The following conditions may indicate potentially significant estimating deficiencies and excessive costs to the Government:</p> <ul style="list-style-type: none"> • Failure to ensure that historical data on the same or similar work is available to and utilized by cost estimators where appropriate. • Continuing failure to analyze material costs or failure to perform subcontractor cost reviews as required. • Consistent absence of analytical support for significant proposed costs. • Excessive reliance on individual personal judgment where historical experience or commonly used standards are available. • Recurring significant defective pricing findings within the same cost element(s). • Failure to integrate relevant parts of other management systems (e.g., production or cost accounting) with the estimating system. • Failure to provide established policies, procedures, and practices to persons responsible for preparing and supporting estimates. • Management information that does not match the proposal data. • Standards for labor and material costs that are not current. • Changes in make-or-buy decisions that are not disclosed. • Inappropriate or misleading sampling techniques are used in cost estimating.

Tasks	FAR Reference(s)	Additional Information
2. Determine if an estimating system review should be requested.	FAR 15.407-5 Estimating systems [special cost or pricing areas].	Request that an auditor perform an estimating system review if data submitted in a proposal is not well-documented, unverifiable and unsupported, and inconsistent with quality estimates of an adequate estimating system.
3. Request an estimating system survey review from an auditor.	FAR 15.407-5 Estimating systems [special cost or pricing areas].	<p>Using an acceptable estimating system for proposal preparation benefits both the Government and the contractor by increasing the accuracy and reliability of individual proposals. Cognizant audit activities, when it is appropriate to do so, must establish and manage regular programs for reviewing selected contractors' estimating systems or methods, in order to reduce the scope of reviews to be performed on individual proposals, expedite the negotiation process, and increase the reliability of proposals.</p> <p>The auditor survey review will determine:</p> <ul style="list-style-type: none"> • If the source of data for estimates and the procedures for ensuring the data are accurate, complete, and current; • If the documentation developed are maintained in support of the estimate; • If there are assignments of responsibilities for originating, reviewing, and approving estimates; • If there are procedures for developing estimates for direct and indirect cost elements; • If there is coordination and communication between organizational elements responsible for the estimate; and • If the management support includes estimate approval, establishment of controls, and training programs.
4. Review the results of the estimating system survey report.	FAR 15.407-5 Estimating systems [special cost or pricing areas].	When reviewing the auditor's survey report, address the acceptability of the contractor's estimating system and any factors that affect estimate development.

Tasks	FAR Reference(s)	Additional Information
5. Provide an initial determination of the estimating system to the contractor.	FAR 15.407-5 Estimating systems [special cost or pricing areas].	Provide an initial determination to the contractor in writing.
6. If the initial determination deems the estimating system adequate, issue a final determination.	48 CFR 252.215-7002 - Cost estimating system requirements.	<p>As a result of the review, the contractor's estimating system is acceptable. An acceptable estimating system:</p> <ul style="list-style-type: none"> • Is maintained, reliable, and consistently applied; • Produces verifiable, supportable, documented, and timely cost estimates that are an acceptable basis for negotiation of fair and reasonable prices; • Is consistent with and integrated with the contractor's related management systems; and • Is subject to applicable financial control systems.
7. If the initial determination deems that the estimating system has deficiencies, request a response from the contractor.	48 CFR 252.215-7002 - Cost estimating system requirements	<p>If there are deficiencies, the initial determination will describe the deficiency in sufficient detail to allow the contractor to understand the deficiency.</p> <p>For any deficiencies especially significant deficiencies, the contractor must respond within 30 days to a written initial determination from the contracting officer. A significant deficiency means a shortcoming in the system that materially affects the ability of officials to rely upon information produced by the system that is needed for management purposes.</p> <p>If the contractor disagrees with the initial determination, the contractor must state, in writing, its rationale for disagreeing.</p>
8. Evaluate the contractor's response.	48 CFR 252.215-7002 - Cost estimating system requirements	<p>Evaluate the contractor's response and notify the contractor, in writing, of the final determination concerning:</p> <ul style="list-style-type: none"> • Remaining significant deficiencies; • The adequacy of any proposed or completed corrective action; and • System disapproval, if the contracting officer determines that one or more significant deficiencies remain.

Tasks	FAR Reference(s)	Additional Information
9. Issue a final determination on the contractor's estimating system.	48 CFR 252.215-7002 - Cost estimating system requirements.	Issue a final determination, which may include any no deficiencies or significant deficiencies.
10. When deficiencies are found, request a corrective action plan.	48 CFR 252.215-7002 - Cost estimating system requirements.	The contractor has 45 days from receipt of the final determination to submit an acceptable corrective action plan showing milestones and actions to eliminate the significant deficiencies.
11. Take measures to protect the Government's interest when an estimating system is inadequate.	48 CFR 252.215-7002 - Cost estimating system requirements.	<p>Consider the following alternatives:</p> <ul style="list-style-type: none"> • Allow additional time for proposal preparation/revision. • Consider changing the contract type. • Perform additional cost analysis on cost areas affected by the identified deficiencies. • Segregate suspected cost elements into a cost-reimbursement line item. • Reduce the fee/profit objective. • Insert a reopener clause covering the suspected cost elements.
12. Monitor the contractor's implementation of the corrective action plan.	48 CFR 252.215-7002 - Cost estimating system requirements.	<p>The cognizant auditor and ACO are primarily responsible for monitoring a firm's progress in correcting deficiencies. Should the contractor fail to make adequate progress in correcting deficiencies, several options are available:</p> <ul style="list-style-type: none"> • Highlighting the deficiencies in audit and pricing reports; • Elevating the matter to higher-level contracting management; • Reducing or suspending progress payments until identified deficiencies are corrected; or • Recommending that contracting officers not award contracts until identified deficiencies are corrected.