Policy and Oversight Report

Contract Audit Directorate

Evaluation Report on the
Defense Contract Audit Agency Audits
of Major Contractor Labor Costs

Report Number PO 97-008 February 28, 1997

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Acronyms

DCAA	Defense Contract Audit Agency
DCAAM	Defense Contract Audit Agency Contract Audit Manual
FAO	Field Audit Office

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

February 28, 1997

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Evaluation Report of the Defense Contract Audit Agency Audits of Major Contractor Labor Costs (Report No. PO 97-008)

We are providing this final evaluation report for information and use. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required. The Director, DCAA, should provide us documentation of the corrective actions taken.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. Robert A. Vignola, Program Director, at (703) 604-8896 or Mr. Steven E. Zane, Assistant Program Director, at (703) 604-9191. See Appendix B for the report distribution. The evaluation team members are listed inside the back cover.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Office of the Inspector General, DoD

Report No. PO 97-008
(Project No. 6OC-0090)

February 28, 1997

Evaluation of the Defense Contract Audit Agency Audits of Major Contractor Labor Costs

Executive Summary

Introduction. The Defense Contract Audit Agency Contract Audit Manual Section 5-902a. explains that labor costs are generally the most significant costs charged to Government contracts and generally comprise the base, or the largest element in the base, used to allocate indirect costs. Estimates of labor costs for follow-on or similar item Government contracts are frequently based on historical labor costs. Labor differs from other cost items because it is not supported by third-party documentation such as an invoice, purchase order, or receipt. Contractor personnel have full control over the documents or devices of original entry, whether they consist of time cards, electronic media, or some other means. Accordingly, the risks associated with the accurate recording, distribution, and payment of labor are often significant.

Objective. Our primary objective was to determine the adequacy of the Defense Contract Audit Agency (DCAA) policies, procedures, practices, and training for providing audit coverage of major contractor labor timekeeping and accounting practices. The DCAA defines a major contractor as one with a minimum of $70 million of annual reimbursable contract costs. We examined coverage provided by DCAA field audit offices responsible for 11 major contractors. The annual labor dollars allocable to Government contracts at the 11 contractors was approximately $1.8 billion.

Evaluation Results. DCAA Field Audit Offices cognizant for 11 of 265 major contractors provided labor audit coverage and reporting that was generally adequate except for labor floor checks. The DCAA has sound policies and procedures for performing labor audits; assessing labor-related internal controls, including contractor employee awareness and ethics training programs; issuing comprehensive audit reports on labor and labor-related matters, including reports on computer general and labor application controls, with appropriate recommendations for contractor corrective action; and following up on prior report recommendations. However, labor floor check audits did not fully adhere to the Government Auditing Standards on due professional care, planning, supervision, and examination of evidence. Our evaluation identified three recurring audit deficiencies warranting management action to improve audit coverage.

o At 9 of 11 contractors, floor checks were not performed at significant contractor primary sites (where the books and records are maintained) and/or at significant off-site locations.

o At 9 of 11 contractors, the DCAA did not verify the existence of each employee selected to be floor checked.

o At 7 of 11 contractors, observations of floor checked employees' labor charges were not adequately reconciled with the contractors' accounting distribution of labor charges.

As a result of the incomplete floor check audit coverage, adequate assurance was not provided that labor charges and associated indirect costs were properly charged to Government contracts.

Summary of Recommendations. We recommend the Director, DCAA, advise the field auditors of the three recurring audit deficiencies identified in this report and reemphasize the need to exercise due professional care in planning, performing, and supervising labor floor checks. The Director, DCAA, should also revise the Defense Contract Audit Agency Contract Audit Manual to enhance and clarify the criteria for selecting locations for which floor checks are necessary and to clearly communicate the audit procedures to be followed when contractor employees selected for verification are unavailable. Likewise, the Director, DCAA, should clarify the DCAA "Example Worksheet for Conducting Floor Checks" to incorporate the needed Defense Contract Audit Agency Contract Audit Manual guidance on the appropriate audit procedures to be performed regarding absent contractor employees selected for verification. Additionally, the Director, DCAA, should develop training for supervisors and auditors on floor checks that includes coverage of the selection of contractor locations, the verification of the existence of selected contractor employees, and the reconciliation of observations with the accounting distribution of labor charges.

Management Comments. The Acting Assistant Director, Policy and Plans, DCAA, responded to a draft of this report on January 3, 1997. He concurred with the recommendations and offered adequate plans for implementation. See Part III for the complete text of the response.

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Part I - Evaluation Results

Evaluation Background

The Defense Contract Audit Agency Audit Manual (DCAAM) Section 5-902a. explains that labor costs are generally the most significant costs charged to Government contracts and generally comprise the base, or the largest element in the base, used to allocate indirect costs. Estimates of labor costs for follow-on or similar item Government contracts are frequently based on historical labor costs. Labor differs from other cost items because it is not supported by third-party documentation such as an invoice, purchase order, or receipt. Contractor personnel have full control over the documents or devices of original entry, whether they consist of time cards, electronic media, or some other means. Accordingly, the risks associated with the accurate recording, distribution, and payment of labor are often significant.

The absence of third-party documentation places the sole burden for the integrity of labor costs on contractors' systems of internal controls. Accordingly, internal controls related to the accumulation and distribution of labor costs must be well established and given adequate audit coverage to ensure that labor costs are accurately accumulated or recorded, properly reported or presented for payment, and are reliable for estimating future contracts.

The primary audit objective in reviewing labor costs is to evaluate the propriety of contractor labor charges to contracts, indirect accounts, and other cost objectives. To help achieve the objective, the Defense Contract Audit Agency (DCAA) established Mandatory Annual Audit Requirement Number 6, "Labor Floor Checks or Interviews." The DCAAM 6-1S1 Supplement explains that the purpose of the annual requirement is "To test the reliability of employee time records, that employees are actually at work, that they are performing in assigned job classifications, and that time is charged to the proper cost objective."

DCAAM Section 6-405.1b. states, "Floor check procedures are appropriate when there is limited government risk or vulnerability. If conditions indicating a high probability of mischarging exist, a comprehensive analysis of labor charging and allocation, including employee interviews, . . . is appropriate." Floor checks include asking selected contractor employees various timekeeping-related questions. The DCAA performed labor floor checks at each of the 11 contractors visited in our evaluation.

DCAAM Section 6-405.1e. explains, "Floor check procedures include reviewing the contractor's timekeeping procedures, selecting employees to be floor checked, gathering background data, performing the floor checks, and summarizing the results."

Evaluation Objective

Our primary objective was to determine the adequacy of the DCAA policies, procedures, and practices for providing audit coverage of major contractor labor timekeeping and accounting practices. We specifically wanted to evaluate the adequacy of the audit coverage of employee time charges to Government contracts at contractors' off-site locations. The DCAA defines a major contractor as one with a minimum of $70 million of annual reimbursable contract costs. We examined coverage provided by DCAA field audit offices responsible for 11 major contractors. The annual labor dollars allocable to Government contracts at the 11 contractors was approximately $1.8 billion. Our evaluation encompassed FAOs from each of the 5 DCAA regions and 10 of the contractors had Government contract work at the primary location we visited as well as off-site. Many contractors had several off-site locations.

Additional evaluation objectives included assessing the adequacy of pertinent DCAA audit guidance, related audit programs, and relevant training materials.

Improvements in Labor Floor Checks Are Needed

Our evaluation of DCAA Field Audit Offices (FAOs) cognizant of 11 of 265 major contractors found the labor audit coverage and reporting to be generally adequate except for labor floor checks. The DCAA has sound policies and procedures for performing labor audits; assessing labor-related internal controls, including contractor employee awareness and ethics training programs; issuing comprehensive audit reports on labor and labor-related matters, including reports on computer general and labor application controls, with appropriate recommendations for contractor corrective action; and following up on prior report recommendations. The annual labor dollars allocable to Government contracts at the 11 contractors in our evaluation was approximately $1.8 billion. However, labor floor check audits did not fully adhere to the Government Auditing Standards on due professional care, planning, supervision, and examination of evidence. Three areas warrant management action to improve audit coverage.

o The existing DCAAM guidance does not adequately present the criteria to be considered in selecting contractor locations for floor checks.

o DCAAM guidance and the DCAA "Example Worksheet for Conducting Floor Checks" do not clearly communicate the audit procedures to be followed when contractor employees selected to be floor checked are unavailable.

o The audits generally did not fully adhere to the DCAA audit requirement to reconcile observations of employee time charges with contractors' labor distribution records. No training material on floor checks reinforces the requirement.

As a result of the incomplete floor check audit coverage, adequate assurance was not provided that labor charges and associated indirect costs were properly charged to Government contracts.

Selection of Contractor Locations To Be Floor Checked

Many contractors perform Government contract work at geographically dispersed locations. The DCAA is responsible for auditing the contractor's labor costs, including floor checks of employee time charges, at all contractor locations where significant labor charging occurs. The floor check audits are an integral part of the audit coverage of labor costs and help ensure the propriety of labor charges generated at these sites. The Agency's Mandatory Annual Audit Requirements specify that labor floor checks are to be performed annually.

Labor floor check audit coverage should be provided commensurate with the assessed risk at each location. Professional audit judgment must be exercised in selecting contractor locations to be floor checked. Factors to consider include:

- number of employees and their job classifications,
- contract mix,
- materiality of the contracts,
- special contract provisions,
- audit history,
- assessment of the adequacy of contractor internal controls including contractor internal audits,
- audit leads, and
- input from the contracting officer.

The DCAA FAO cognizant of the primary location (where the books and records are maintained) must request assist audits from other DCAA offices at contractor off-site locations selected to be floor checked. The assist audit requests should be made early in the contractor's fiscal year to allow sufficient time for the DCAA FAOs cognizant of the off-site locations to plan and perform the audits. Appropriate follow-up effort must be exercised to ensure the requested assist audits are performed.

Performance of Floor Checks. At 9 of 11 contractors, floor checks were not performed at contractor primary sites and/or at off-site locations where significant labor costs were being charged to Government contracts.

We found instances where no floor check assist audits were requested for contractors with off-site locations that had a significant number of employees and a mix of contracts. If a contractor location has a mix of contracts, such as cost-type and fixed-price or commercial contracts, the location has a higher risk of labor mischarging than a location with only one contract or one contract type. For example, one contractor had 339 locations, which included 15 off-site locations each having more than 125 employees and a mix of contracts. Floor check assist audits were not requested for the contractor fiscal year ended January 31, 1995. The working papers explained that a 1991 audit assignment included many assist audits with minimal findings disclosed. While the FAO showed some improvement in its floor check coverage for the contractor's fiscal year ended January 31, 1996, it failed to perform appropriate follow-up effort on three requested assist audits. Another FAO did not properly follow up on two requests for assist audits. As a result, the two offices requested five assist audits that were not performed. At another major contractor, the floor check assist audits were not requested until 2 weeks before the contractor's fiscal year end. Such untimely requests do not provide the off-site auditors adequate time

to schedule and perform the audits before the contractor's year end and significantly reduce the opportunity to observe the labor charging during the year.

Improved Guidance Needed. The existing DCAAM guidance could be improved to enhance and clarify the criteria to consider in selecting contractor locations for floor checks. The DCAAM Section 6-405.3, "Procedures for Performing Physical Observations (Floor Checks)," states, "The extent and frequency of floor checks should depend upon the adequacy and reliability of the contractor's system for controlling time, internal controls, the frequency and effectiveness of floor checks by contractor personnel, and the reliability of the records indicated as a result of floor checks. Consider the procedures described below in conducting a floor check." Subparagraph a. states, in part, "A listing of employees by location will be helpful in determining any necessary assist audits. If significant numbers of employees are at offsite locations, consider requesting assist audits." Expanding the criteria to consider in selecting locations to be floor checked could improve the guidance by including contract mix, materiality of the contracts, employee job classifications, special contract provisions, audit leads, and input from the contracting officer.

Due Professional Care in Planning and Supervising Audits. The third general standard in the Government Auditing Standards requires due professional care in conducting the audit. The exercise of due professional care includes the use of sound professional judgment in establishing the scope and methodology of the audit. The field work standards require that the work be adequately planned and assistants, if any, be properly supervised. Another standard of field work requires that sufficient, competent evidential matter be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an audit opinion. The use of due professional care in planning and supervising floor check audits, at a primary contractor location, requires consideration of the above criteria in selecting the locations to be floor checked to obtain the evidential matter needed to properly support an audit opinion.

A renewed emphasis on due professional care and proper audit planning and supervision is needed to ensure floor checks are performed where appropriate. Most of the FAOs visited did not adequately plan the floor check audit coverage. Some FAOs did not consider any off-site locations while others failed to request assist floor check audits of certain significant off-site locations. Two FAOs did not perform an annual floor check at the contractor's primary site. Audit supervisors and staff should exercise due care in planning and performing the audits to ensure that necessary floor checks are performed and that assist audit requests are timely. Due care in coordinating and following up is needed to ensure the performance of requested assist audits. For example, a requested assist audit made to an FAO that no longer has audit cognizance of an off-site location should be performed by the FAO that gained audit cognizance. FAOs should communicate such changes and coordinate with each other in a timely manner to ensure that requested audits are performed. Training should be developed to educate supervisors and auditors on how to properly plan and perform floor checks.

Verification of Existence of Selected Employees

The selection of employees for floor checking is generally made from a recent list of employees charging contracts in the department or cost center being audited. Some employees selected to be questioned are usually unavailable at the precise time the auditors make their observations because floor checks are unannounced. In these circumstances, the auditors should record in the working papers the reasons given for the employees' absence, such as in a meeting, on break, and on leave. The selection of another employee to be floor checked, also known as an employee substitute, is appropriate in such circumstances as when an individual originally selected to be floor checked is no longer employed by the contractor or is on a long term-leave of absence. However, the unavailable employee status must be verified with the contractor's personnel office.

When an employee is on a break or in a meeting, the contract auditor must follow up to verify the employee's existence and conduct the floor check to obtain the evidential matter needed to properly complete the audit. Follow up is easily performed at large contractor locations as DCAA auditors are stationed there full-time. At contractor locations audited in a mobile environment (auditors are not stationed there), auditors must exercise sound professional judgment in determining the appropriateness of performing follow-up effort versus selecting employee substitutes. Factors to consider include the number of unavailable employees and the veracity of the contractor's reason for an employee's absence by verification through other sources.

Audit Practice. At 9 of 11 contractors, the DCAA did not verify the existence of each contractor employee selected to be floor checked. Accordingly, the auditors did not obtain sufficient competent evidential matter needed to support their audit conclusions and opinion on labor costs. The DCAA auditors generally recorded in their working papers the reasons given as to why employees were not at their work stations at the time of the floor checks. However, the auditors frequently did not follow up to meet the unavailable employees at a later time or date. We also found instances in which employee substitutes were floor checked where it would have been appropriate to perform follow up effort instead of or in addition to the substitutes observed.

Improved Guidance Needed. DCAAM guidance and the DCAA "Example Worksheet for Conducting Floor Checks" provide limited information on how to conduct floor checks. The DCAAM guidance could be improved by clearly communicating the audit procedures to be followed when selected contractor employees are unavailable. The guidance should explain when it is appropriate to select another employee to be floor checked and the follow-up effort that should be performed for absent employees. The DCAA "Example Worksheet for Conducting Floor Checks" should incorporate the added guidance or refer to the DCAAM. The guidance should also be incorporated in training materials on floor checks to reinforce the required procedures. Both supervisors and auditors should receive the new training because the condition was observed at most FAOs visited and the supervisors did not correct the deficient procedures.

Reconciliation of Observations With Labor Distribution

DCAAM Section 6-405.3(o) requires auditors to "Determine whether the observations made during the floor check are properly reflected on the payroll and labor distribution records." The DCAA standard "Labor Interview/ Floorcheck Audit Program," Version 1.0, dated June 27, 1994, Section H, Step 13, states, "Reconcile the observations regarding the employees' labor charges with subsequent payroll and/or labor distribution records and follow-up on any discrepancies." The audit procedure provides evidential matter necessary to help support an audit opinion on the propriety of the allocation of labor costs to Government contracts.

Generally, contractors maintain their labor accounting records at the primary work location. Accordingly, the auditors performing assist audits of off-site employees must provide the primary location auditors with the observations made during the off-site floor checks. The auditors at the primary location are responsible for reconciling the observed labor charging from the floor checks to the distribution of labor charges to contracts and other cost objectives in the accounting records.

At 7 of 11 contractors, observations of floor checked employees' labor charges were not adequately reconciled to the labor distribution in the accounting records. Although audit reports on off-site floor checks often provided information on the floor check observations, along with advice on the need to perform the referenced reconciliation at the contractor's primary location, the reconciliation of off-site observations was usually not performed. There was a breakdown in the follow up required to complete the verification process. However, the reconciliation of floor check observations made at primary work locations was performed in most instances.

Two FAOs traced entries on contractor employees' partially completed time cards to the contractors' accounting records. In both cases, the partially completed time cards contained labor charges through the close of business for the day before the floor checks and excluded the labor charge for the effort being worked on at the time of the observation. Neither FAO determined whether the charge number corresponding to the assignment being worked on at the time of the floor check (which is the employee observation) reconciled to the contractor's labor distribution. At one of the two FAOs, we noted that a recorded floor check observation did not reconcile to the contractor's labor distribution and the audit working papers did not identify the discrepancy. The discrepancy should have been identified and action taken to resolve the matter. The same FAO failed to record several floor check observations. The observations must be recorded and subsequently reconciled to the contractor's labor distribution. Audit supervisors should ensure the required audit procedure is properly performed. Due care was not exercised to ensure the reconciliation of the observations of employees' labor charges to the contractor's labor distribution.

A renewed emphasis on due professional care and proper audit planning and supervision along with the development of training on floor checks is needed to

achieve increased adherence to DCAA audit policy and guidance. Supervisors and auditors alike need to be trained in the entire floor check process including the reconciliation of observations to the accounting records.

Summary

Physical observations of contractor employee time charging is an effective audit procedure for ensuring the integrity of labor charges to Government contracts. The presence of Government auditors conducting unannounced floor checks is a deterrent to labor mischarging. However, the DCAA could further reduce the risk of labor mischarging on Government contracts by improving audit practices and procedures. Greater attention should be given to locations warranting floor check audits, the verification of the existence of selected contractor employees, and the reconciliation of floor check observations with the contractor's labor distribution. Training on floor checks that includes coverage of these areas should be developed. Improvements in floor check procedures will help assure that labor charges and associated indirect costs are properly recorded in contractors' cost accounting records and, in turn, that contractor billings, close out of contracts, and estimates of future contract costs properly reflect accurate labor charges.

Recommendations and Management Comments

We recommend the Director, Defense Contract Audit Agency:

1. Advise the field auditors of the three recurring audit deficiencies identified in this report and reemphasize the need to exercise due professional care in planning, performing, and supervising labor floor checks.

Management Comments. The Defense Contract Audit Agency concurred and agreed to issue a memorandum, 90 days after receipt of this report, to all field audit offices advising them of the deficiencies identified in this report and reemphasizing the importance of floor checks.

2. Revise the Defense Contract Audit Agency Contract Audit Manual to:

a. Enhance and clarify the criteria for selecting contractor locations to be floor checked.

b. Clearly communicate to the professional staff the audit procedures to be followed when contractor employees selected to be floor checked are unavailable. The guidance should explain the follow up required to verify the existence of absent employees and the appropriate use of contractor employee substitutes.

Management Comments. The Defense Contract Audit Agency concurred and stated it will revise the next Contract Audit Manual to enhance and clarify the criteria for selecting locations for floor checks and to include the procedures to be followed when employees selected for floor checks are unavailable.

3. Amend the Defense Contract Audit Agency "Example Worksheet for Conducting Floor Checks" to incorporate the Defense Contract Audit Agency Contract Audit Manual guidance recommended in 2.b. above.

Management Comments. The Defense Contract Audit Agency concurred and plans to revise the Agency "Example Worksheet for Conducting Floorchecks" in the next Defense Contract Audit Agency Integrated Information System update following the Contract Audit Manual revision to reflect the guidance incorporated in the Contract Audit Manual as a result of Recommendation 2 above.

4. Develop training for supervisors and auditors on floor checks that includes coverage of the selection of contractor locations, the verification of the existence of selected contractor employees, and the reconciliation of observations with the accounting distribution of labor charges.

Management Comments. The Defense Contract Audit Agency concurred and stated that, by June 30, 1998, it will develop training on floor checks that will include the selection of contractor locations, the verification of selected employees, and the reconciliation of floor check observations with the distribution of labor charges.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We conducted this evaluation from October 1995 through May 1996 and made field visits to DCAA FAOs cognizant of 11 major contractors from December 1995 through March 1996. To accomplish the objective, we:

o coordinated with Headquarters, DCAA, and evaluated the adequacy of:

- guidance on auditing and reporting on labor costs,

- relevant audit programs and internal control audit planning summary documents, and

- current training materials pertaining to contractor labor timekeeping and accounting practices and

o reviewed the adequacy of audit coverage of major contractor labor timekeeping and accounting practices at each DCAA FAO visited including evaluation of the following data:

- completed floor checks (including working papers and the audit reports) for the contractor's most recently completed fiscal year and current year-to-date;

- all other DCAA labor-related reports issued during the contractor's current and most recently completed fiscal year and related working papers;

- most recently completed incurred cost audit report, comprehensive labor report, and reports on labor internal controls including electronic data processing general and labor applications controls and associated working papers;

- data pertaining to employee population and contract mix for each contractor location;

- pertinent labor statistical data;

- latest audited financial statements;

- documentation pertaining to reliance on the work of other auditors, as applicable;

- the DCAA requirements and program plans for Government FYs 1995 and 1996;

- Internal Control Audit Planning Summary for the Labor Accounting System for Government FYs 1995 and 1996;

- completed audit program for Reviewing and Reporting on Contractor Labor Accounting System and Related Internal Controls and the completed Labor Interview/Floor Check Audit Program along with the applicable working papers;

- FAO Management Information System reports showing all labor-related assignments worked on during Government FYs 1995 and 1996;

- information on and status of outstanding labor-related issues; and

- data pertaining to recent ownership changes/reorganizations.

Methodology

We selected 10 of the 11 DCAA offices evaluated because they were cognizant of major contractors with off-site locations. We wanted to evaluate the adequacy of labor audit coverage of off-site locations as a part of the evaluation. While one office did not have any off-site locations, it was included in our evaluation because of its close geographical proximity to one of the other offices selected. Our evaluation encompassed FAOs from each of the five DCAA regions. We reviewed the data referenced in the scope section above and held discussions with representatives from DCAA Headquarters, Regional Offices, and FAOs.

We visited or contacted individuals and organizations within the DoD. Further details are available on request.

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Part III - Management Comments

Defense Contract Audit Agency Comments

DEFENSE CONTRACT AUDIT AGENCY
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FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PIC 225.4

3 January 1997

MEMORANDUM FOR DIRECTOR, AUDIT POLICY AND OVERSIGHT

SUBJECT: Draft Report on Evaluation of DCAA Audits of Major Contractor Labor Costs (Project No. 60C-0090)

As requested in your memorandum of 1 November 1996, we reviewed the subject draft report. Our response to the report follows:

We concur with your recommendations in the draft report. In response to your recommendations, DCAA will perform the following:

1. Ninety days after receipt of your final report, issue a memorandum to all field audit offices (FAOs) advising them of the deficiencies identified in your report and reemphasizing the importance of floor checks.

2. Revise the next DCAA Contract Audit Manual (CAM) after receipt of your final report to enhance and clarify the criteria for selecting locations for floor checks and the procedures to be followed when employees selected for floor check are unavailable.

3. Revise the DCAA "Example Worksheet for Conducting Floor Checks" in the next DIIS update following the CAM revision to reflect the guidance incorporated in the CAM as a result of No. 2. above.

4. By 30 June 1998, develop training on floor checks that includes selection of contractor locations, verification of selected employees and reconciliation of floor check observations with distribution of labor charges.

Although we concur with your recommendations, we wish to make the following observations:

Regarding your finding that "At 9 of 11 contractors, floor checks were not performed at significant contractor primary sites (where the books and records are maintained) and/or at significant off-site locations," we wish to note that, as stated in your report, in all but two cases, the floor checks that were not performed were for off-site locations. Moreover, in at least one instance, the FAO had decided that floor checks were not required because the off-site locations were low risk and/or had few employees.

PIC 225.4
SUBJECT: Draft Report on Evaluation of DCAA Audits of Major Contractor Labor Costs (Project No. 60C-0090)

Regarding your finding that "At 9 of 11 contractors, the DCAA did not verify the existence of each employee selected to be floor checked," as we informed you during the preparation of your draft report, in some cases, it may not be reasonable in the circumstances to perform follow-up effort to verify an employee's existence; e.g., where a floor check is performed at a mobile contractor off-site location, only a few individuals are in question, and other alternate steps are taken to obtain the additional assurance needed.

Regarding your finding that "At 7 of 11 contractors, observations of floor checked employees' labor charges were not adequately reconciled with the contractor's accounting distribution of labor charges," one could infer from this statement that there was no reconciliation. In some cases, a sample rather than 100 percent of the floor check observations was reconciled. In these cases, a sample reconciliation may be sufficient. This is because of the differing objectives of the floor checks themselves versus the reconciliations; i.e., the floor checks must adequately cover the differences that each individual brings to the time recording system, while the reconciliation is primarily directed at assessing the workings of a single labor distribution system.

Please direct any questions regarding this memorandum to Mr. Patrick Duffy, Program Manager, Incurred Cost Division, at (703) 767-2250.

Daniel J Trecciarone
for Lawrence P. Uhlfelder
Assistant Director
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2

Evaluation Team Members

This report was prepared by the Contract Audit Directorate, Office of the Assistant Inspector General for Policy and Oversight, DoD.

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