



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAS 730.1

February 7, 2003
03-PAS-014(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Amendment to MRD 03-PPD-002(R), Audit Guidance on Special Purpose Audits of Contract Overpayments and Progress Payments for FY 2003, dated January 3, 2003

The subject Memorandum for Regional Directors (MRDs), which provided guidance on special purpose audits of contract overpayments and progress payments, is amended to include the attached audit program in a table format (as it will appear in the next APPS update) to make it easier to incorporate into the APPS working papers. Also attached are 17310 – Proforma Memorandum for Record, 17310 – Proforma Notification to Payment Office, and 17310 - Proforma Request for Assist Audit that were included as attachments to the original MRD. These attachments have been reformatted and renamed and will also be included in the next update of Audit Planning and Performance System (APPS), as part of the actual delivered APPS package. The 17310 – Proforma Memorandum for Record will be accessed by clicking on the REPORT/MEMO tab within the APPS package. The other two attachments to the original MRD will be included in Other Audit Guidance.

Field auditors are advised to use the attached documents to facilitate the creation of APPS working paper packages for the above referenced audits until the release of the next APPS update. In the meantime, these documents can also be found on the DCAA Intranet page under Standard Audit Programs.

Questions regarding this memorandum may be addressed to Kenneth W. Anderson, Program Manager, Auditing Standards division at (703) 767-3274.

/Signed/
Robert DiMucci
Assistant Director
Policy and Plans

DISTRIBUTION: C

Attachments (4)

1. 17310 - Audit Program for Audit of Contract Overpayments
2. 17310 – Proforma Notification to Payment Office
3. 17310 – Proforma Memorandum for Record
4. 17310 – Proforma Request for Assist Audit

B-1	Planning Considerations
Purpose And Scope	
<p>1. Purpose. This audit is intended to verify that contractors’ billing system procedures and internal controls are in place to accomplish the following objectives:</p> <ul style="list-style-type: none"> • Compare billings with cash receipts to identify contract overpayments and ensure amounts due the government are refunded or offset in a timely manner; • Identify and resolve overpayments due to liquidation differences in a timely manner; • Reconcile recorded to billed costs to ensure costs are not over billed; • Identify contract administration adjustments to determine if adjustments are needed to billings and, if so, that they are computed correctly and appropriate refunds or offsets are processed timely; • Ensure timely and documented responses are prepared in response to demand letters; • Review contractors’ processes for monitoring subcontractor billings and identifying/resolving any overpayments timely; • Ensure offsets are properly authorized, adequately documented, and applied against billings for previously identified overpayments; • Ensure refunds are processed in a timely manner; and • Timely notification to the cognizant paying office and contracting officer timely of significant overpayments. <p>This program is limited to the audit of the billing system procedures and internal controls outlined in Section E of the audit program. During the preliminary audit steps, the auditor should identify any billing system procedures and internal control reviews performed by the contractor relating to this audit area. In those cases where internal reviews have been performed that relate to specific audit steps included in this audit program, the auditor should follow the guidance contained in CAM 4-1000, Reliance on the Work of Others.</p> <p>The audit should be conducted in accordance with the generally accepted government auditing standards to the extent applicable under the circumstances. The steps in the program are intended as general guidance and should be modified as necessary to fit the current evaluation. Those steps not required should be deleted or marked “not applicable” (N/A).</p>	
<p>2. Scope. The audit steps selected for completion, or added as necessary, represent a determination of requirements based on auditor judgment and a clear understanding of the purpose of the audit.</p>	
Definitions	
<p>1. Contract Overpayments. Overpayments are payments that the contractor receives that are in excess of billed amounts. Overpayments may also result from differences between recorded and billed costs. Major causes of overpayments include: (i) weaknesses in contractor internal controls; (ii) contract administration adjustments; (iii) and paying office errors.</p>	
<p>2. Accounting for Progress Payment Liquidations. The government liquidates (recoups) progress payment amounts previously provided to contractors by deducting these amounts from the payment</p>	

<p>requested on the appropriate contractor delivery invoice. Consequently, the contractor should have procedures to reduce delivery invoice amounts by any prior progress payment requested amounts related to the delivery invoice. This net delivery invoice amount should be recorded in the contractor's accounts receivable records for comparison purposes to amounts received to identify and resolve any differences.</p>
<p>3. Contract Administration Adjustments. Contract administration adjustments include payments the contractor received in accordance with contract provisions, which need to be reduced because of subsequent events or actions. Contract administration adjustments may result from contract administration related actions, such as:</p>
<ul style="list-style-type: none"> • progress payment adjustments due to a contract loss position;
<ul style="list-style-type: none"> • changes in contract billing prices, liquidation rates, and foreign exchange rates;
<ul style="list-style-type: none"> • quarterly limitation of payment adjustments;
<ul style="list-style-type: none"> • government withholds as a result of contract performance problems; and
<ul style="list-style-type: none"> • settlement of final indirect rates, cost accounting standard noncompliances, or postaward audits.
<p>4. Demand Letters. Letters issued by the paying office or contracting officer demanding payment of specified amounts by the contractor. The demand letter notifies the contractor that amounts not paid within 30 days of the demand letter shall bear interest.</p>
<p>5. Offsets. An offset is a reduction applied to an invoice submitted to the paying office as a means of resolving payment issues such as overpayments, contract administration adjustments, and paying office/contractor errors.</p>
<p>6. Refunds. Checks submitted to the government during a specific time period.</p>
<p>References</p>
<p>1. Standard Audit Program APBILL - Audit Program for Reviewing and Reporting on Contractor Billing System and Related Internal Controls.</p>
<p>2. CAM 5-1100, Section 11 – Audit of Billing System Internal Controls</p>
<p>3. CAM 6-203 – Credits and Refunds on Cost-Type Contracts</p>
<p>4. CAM 6-705 – Interim Cost-Reimbursable Billings</p>
<p>5. CAM 6-900, Section 9 – Notice of Cost Suspensions and Disapprovals Under Cost Reimbursable Contracts</p>
<p>6. CAM 6-1000, Section 10 – Responsibilities for Processing and Approval of Interim and Completion Cost-Reimbursable Vouchers</p>
<p>7. CAM 14-200, Section 2 – Audit of Progress Payments</p>
<p>8. MRD 02-PPD-044(R), May 23 2002 - Supplemental Audit Guidance on Special Purpose Audits of Contract Overpayments</p>

B-1	Preliminary Steps	
		WP Reference

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1. Conduct an entrance conference as outlined in CAM 4-302, with particular emphasis on the following areas:	
a. Purpose of Audit. Explain to the contractor that this audit is intended to verify that the contractor's billing system procedures and internal controls are in place to assure timely identification and resolution of contract overpayments including comparison of billed and paid amounts, liquidation differences, recorded to billed costs; contract administration adjustments, demand letters, and subcontractor overpayments.	
b. <u>Comparison of Billed and Paid Amounts.</u> Request the contractor to provide a copy of such a comparison and explain:	
(1) its procedures for comparing amounts billed to amounts received at the invoice level, its accounting procedures for applying progress payment liquidations on delivery invoices and recording the net delivery invoice amount in the accounts receivable records for comparison to amounts received, and the process for resolving payment variances (including notifying the government or prime contractor when overpayments are identified and returning the overpayments),	
(2) a listing of all current outstanding payment variances on prime contracts and subcontracts (including variances due to liquidation differences), and	
(3) the current accounts receivable and accounts payable aging reports.	
c. <u>Reconciliation of Recorded to Billed Costs.</u> Request the contractor to provide a copy of such a reconciliation and explain:	
(1) its procedures for performing the periodic reconciliation of recorded to billed costs,	
(2) a schedule of the reconciliation of recorded and billed costs for all significant contracts and subcontracts (including physically complete contracts awaiting closeout with no recent billing activity), and	
(3) a list of all physically complete contracts awaiting closeout.	
d. <u>Contract Administration Adjustments.</u> Request a listing of contract administration adjustments processed over the last 12 months. Request the contractor to explain its procedures for processing contract administration adjustments impacting billings.	
e. <u>Demand Letters.</u> Request the contractor to provide a listing of demand letters processed over the last 12 months. Request the contractor to explain its procedures for processing government demand letters for payments.	
f. <u>Subcontractor Billings.</u> Request the contractor to explain its procedures for monitoring subcontractor billings and to provide a list of the top 3-5 subcontracts, including subcontract values. Based on the contractor's explanation and a review of the subcontractor listing, determine if assist audits are required. See StepG-1, 2.	
g. <u>Offsets.</u> Request a listing of all offsets processed over the last 12	

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months. Request the contractor to explain its procedures for processing offsets.	
h. <u>Refunds</u> . Request the contractor to provide a listing of all refunds processed over the last 12 months. Request the contractor to explain its procedures for processing refunds to the government.	
2. Evaluate permanent files (including previous assessments of the accounting and billing internal control systems and control risk summarized on the ICAPS sheets and audit leads) and prior audits to determine what relevant audit effort has been performed relating to the detailed audit steps described in Section E below.	
3. Consider the extent and results of the contractor’s self-governance activities, internal and external audits, coordinated audits, etc., relating to this area. Follow the guidance contained in CAM 4-1000, Reliance on the Work of Others. Document your evaluation.	
4. FAOs that have cognizance of contractors with significant classified contracts should coordinate with the Field Detachment to determine the DCAA office with responsibility for identifying and reviewing overpayments on classified contracts. This coordination should be documented in the working papers. FAOs should also coordinate with the Field Detachment on any significant overpayments found on classified contracts during FY 2003.	
5. Close coordination is required at FAOs cognizant of a shared services location and the FAOs cognizant of the segments serviced by the shared services. Document the objectives and procedures to be performed at the shared services location and the segment level.	
6. At contractors with significant reimbursable (non-DoD) contracts, coordinate with the regional Task Force member to determine if the reimbursable contracts should be included in the audit.	

C-1	Comparison of Billed and Paid Amounts	WP Reference
1.	Review the contractor’s written policy and procedures and assess their adequacy for identifying and resolving contract overpayments in a timely manner. The contractor should:	
a.	perform comparisons of amounts received to amounts billed at the invoice level (e.g., for each public voucher, progress payment request, performance based payment, and delivery invoice) to readily identify contract overpayments (Note: Overpayments and underpayments should not be netted.),	
b.	document timely notification of overpayments to the contracting officer and paying office,	
c.	document compliance with contracting officer and paying office instructions to resolve overpayments,	
d.	resolve overpayments within 30 days after the overpayment was made and document significant activities during the resolution process (e.g., e-mails, conversations, meeting, etc.), and	
e.	ensure that on contracts with progress payments, that the appropriate progress payment liquidation is applied against the delivery invoice when the delivery invoice is submitted. The contractor should have	

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procedures to:	
(1) brief the contract to identify the appropriate liquidation rate,	
(2) apply the appropriate liquidation rate against the delivery invoices and record the net amount in the accounts receivable records (for comparison to amounts received),	
(3) identify payment variances as a result of differences in application of liquidations between the paying office and the contractor,	
(4) research payment variances to determine if overpayments exist,	
(5) immediately refund overpayments due to liquidation errors and coordinate with paying office and resolve within 30-60 days (refund or offset on next billing) if overpayments are due to timing differences.	
2. Review the accuracy and completeness of the contractor's listing of outstanding overpayments.	
a. Selectively review the contractor's comparisons of amounts received to amounts billed and other contractor documentation to determine if the list of payment variances is accurate and complete.	
b. Review outstanding amounts on the aged accounts receivable and accounts payable listings to ensure these amounts are appropriately included on the list of outstanding overpayments.	
c. Determine if the contractor's listing of overpayments includes all payment variances as a result of delivery invoice liquidation differences between the contractor and paying office. Review the contractor's accounting procedures for progress payment liquidations (See 1.e. above) to verify that all outstanding variances have been identified. If liquidation differences are not identified, develop audit steps to identify the differences.	
d. Make any adjustments to the contractor's listing as a result of steps 2.a., b., and c. above.	
3. Select a sample of significant outstanding overpayments to:	
a. obtain information on the overpayment; e.g., a copy of the invoice, copies of payment records showing invoice amount and date, payment amount and date,	
b. document the reason for the overpayment, and	
c. obtain the contractor's rationale for not returning the overpayment, and its documented significant activities to resolve differences.	
4. Immediately notify the paying office via memorandum if a significant contractor overpayment (\$50 thousand or more individually or \$50 thousand on a single contract) is disclosed during the audit and (1) the contractor has not notified the government, or (2) the overpayment is over 30 days old and has not been returned. Use the pro forma memorandum (17310 – Proforma Notification to Payment Office) to make this notification.	

D-1	Reconciliation of Recorded to Billed Costs	WP Reference
1.	Review the contractor's written policy and procedures and assess their adequacy for reconciling recorded to billed costs and submitting timely	

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credit billings and refunds where billed cost exceeds incurred cost due to subsequent cost reductions to the contract. Ensure that the contractor:	
a. reconciles recorded and billed costs on a periodic basis on both in-process and physically complete (but not closed) contracts, and	
b. submits credit billings and refunds timely when billed costs exceed recorded costs.	
2. Review the contractor’s reconciliation of recorded to billed costs to verify it includes all significant contracts (including all open physically completed contracts with no recent billing activity). Compare the contracts included in the contractor’s reconciliation schedule to a verified listing of in-process and physically complete contracts. Determine that the calculation of recorded costs (for this comparison purpose) is based on acceptable indirect rates (See CAM 6-705.1.d).	
3. For any contract where billed costs exceed recorded costs, request the contractor to process credit billings and refunds. If the contractor does not make adjustments to billings to reflect allowable recorded costs, the FAO should consider issuing a DCAA Form 1 on cost-type contracts. For other than cost-type contracts (or in those instances where it is not feasible to issue a DCAA Form 1), the FAO should notify the contracting officer and paying office of the overpayment using the attached proforma memorandum (17310 – Proforma Notification to Payment Office).	

E-1	Contract Administration Adjustments	WP Reference
1.	Review the contractor’s written policy and procedures and interview personnel in the contracts and billing departments to assess the adequacy of the contractor’s procedures for processing timely contract administration adjustments. Ensure that the contractor:	
	a. maintains a schedule of contract administration adjustments,	
	b. Computes adjustments accurately, and	
	c. reflects the impact of contract administration adjustments in billings or refunds within 30 days of the date of the administration adjustment.	
2.	Verify that the schedule of contract administration adjustments is complete. This verification may be performed by:	
	a. selectively reviewing contract briefings on major contracts to identify required contract administration adjustments such as quarterly limitation of payments,	
	b. reviewing contract modifications on major contracts for the last 12 months to identify any contract administration adjustments and verify that they were included on the list, and	
	c. obtaining the contracting officer’s comments on the completeness and accuracy of the schedule.	
3.	Select and review a sample of significant contract administration adjustments to determine:	
	a. the reason(s) for the contract administration adjustment,	

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b. if the adjustment was computed accurately, and	
c. that a refund or offset was processed within 30 days of the date of the administration adjustment.	
4. Immediately notify the paying office, with a copy to the contracting officer, of any outstanding contract administration adjustment over 30 days old where a refund or offset has not been processed. Use the proforma memorandum (17310 – Proforma Notification to Payment Office) to make this notification.	

F-1	Demand Letters	WP Reference
1.	Review the contractor's written policy and procedures and assess their adequacy for processing government demand letters for payment. Ensure that the contractor's procedures:	
	a. appropriately identify demand letters,	
	b. call for refunds or offsets to be submitted within 30 days of the date of the demand letter, and	
	c. require submission of documentation to the paying office within 30 days after the date of the demand letter if the amount in the demand letter is disputed.	
2.	To test the completeness of the contractor's list of demand letters, coordinate with the regional Task Force member to obtain a listing of demand letters for the contractor from the paying office (request should include contractor CAGE code). Also, verify the completeness of the listing with the contracting officer.	
3.	Select and review a sample of significant demand letters issued during the last 12 months to determine	
	a. the reason(s) for the demand letter,	
	b. that the contractor processed a refund or offset or disputed the debt in a timely manner (i.e., within 30-60 days), and	
	c. that the contractor maintains adequate documentation for its position on any disputed debt	
4.	Immediately notify the paying office, with a copy to the contracting officer, of any demand letter that is over 30 days and has not been properly refunded, offset, or disputed. Also, notify the paying office, with a copy to the contracting officer, of any disputed debt not supported by the contractor or where documentation has not been submitted to the paying office. Use the proforma memorandum (17310 – Proforma Notification to Payment Office) to make this notification.	

G-1	Subcontractor Billings	WP Reference
1.	Review the contractor's written policy and procedures and assess their adequacy for monitoring the adequacy of subcontractor accounting and billing systems and identifying and resolving subcontractor overpayments, contract administration adjustments, offsets, and refunds. Ensure that the contractor's procedures:	
	a. provide for obtaining documentation on the adequacy of	

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<p>subcontractors' accounting and billing systems, including obtaining documentation that the subcontractor provides timely notification to the prime contractor of any overpayments,</p>	
<p>b. provide for obtaining, on a periodic basis, the subcontractor's reconciliation of billed and paid amounts on the subcontract,</p>	
<p>c. require the contractor to immediately notify the subcontractor of any contract administration adjustment impacting the subcontractor's billings and that refunds or offsets are processed within 30 days, and</p>	
<p>d. require the prime contractor to timely adjust its billings or submit refunds to the government for identified subcontractor overpayments that have been included in billings to the government, contract administration adjustments, offsets, and refunds.</p>	
<p>2. Select the top 3-5 subcontracts to verify that the above procedures are being accomplished. If the prime contractor's procedures are not adequately addressing step 1. above, request assist audits from the cognizant FAO.</p>	
<p>a. Assist audits are generally required on subcontracts where the prime contractor does not have visibility over payment variances in the subcontractor accounting records.</p>	
<p>b. The assist audit request should identify the subcontractor name and provide information on the subcontracts to be included in the request, e.g., subcontract number, period of performance, subcontract price, and subcontract type. Use the pro forma memorandum (17310 – Proforma Request for Assist Audit) to request the assist audit.</p>	
<p>c. After receipt of the assist audit, FAOs cognizant of the subcontractor should include the subcontracts in the special purpose audit at the subcontractor location.</p>	
<p>d. At subcontractor locations where a special purpose audit is not otherwise planned for FY 2003, FAOs cognizant of the subcontractor should coordinate the assist audit request with the regional Task Force member before doing any work on the request.</p>	
<p>3. Immediately notify the paying office, with a copy to the contracting officer, of any subcontractor overpayment, contract administration adjustment, offset, or refund that the contractor has not reflected in billings or refunds to the paying office. Use the pro forma memorandum (17310 – Proforma Notification to Payment Office) to make this notification.</p>	

H-1	Offsets	WP Reference
1.	<p>Review the contractor's written policy and procedures and assess their adequacy for processing timely offsets. Ensure that the contractor's procedures:</p>	
	<p>a. allow making significant offsets of overpayments and contract administration adjustments only after notification to, and instruction from, the contracting officer and paying office (and the contractor maintains adequate documentation of this coordination),</p>	

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b. call for making approved offsets on a timely basis, usually within 30 days of identification of the overpayment or contract administration adjustment	
c. call for processing offsets only on the same contract where the overpayment or contract administration adjustment occurred,	
d. allow processing offsets only on valid invoices submitted to the paying office,	
e. do not allow the contract remain in an overpaid status after the offset is processed, and	
f. require that adequate accounting records are maintained to show all offsets at the invoice level and the overpayment/underpayment status for all in-process and physically completed contracts.	
2. Review a sample of significant offsets to determine if they meet the criteria for allowable offsets discussed in 1. above.	
3. The offsets should have already been identified during the review of billed and paid amounts, reconciliation of recorded and billed costs, contract administration adjustments, demand letters, and subcontract billings. If additional items are found during the review of offsets, request the contractor to explain why the items were not included on the schedules provided under Preliminary Audit Steps (B-1) 1.b through 1.f for each of the areas and perform additional audit work, if necessary.	
4. Immediately notify the paying office, with a copy to the contracting officer, of any offsets that do not meet the 6 criteria above, using the pro forma memorandum (17310 – Proforma Notification to Payment Office) to make this notification	

I-1	Refunds	WP Reference
1.	Verify the completeness of the list of refunds (obtained in Preliminary Audit Step (B-1)1.h.) to the government for the last 12 months by selectively comparing the list to checks issued to the government.	
2.	Select a sample of significant refunds to:	
	a. determine the reason(s) for the refund(s) and the adequacy of the documentation related to the refund,	
	b. determine whether the refunds were processed in a timely manner, i.e., 30-60 days after the overpayment occurred.	
3.	The refunds should have already been identified during the review of billed and paid amounts, reconciliation of recorded and billed costs, contract administration adjustments, demand letters, and subcontract billings. If additional items are found during the review of refunds, request the contractor to explain why the items were not included on the schedules provided for the applicable area and perform additional audit work, if necessary, to verify that the schedules discussed in steps B-1, 1.b. through B-1, 1.f. above are complete.	

A-1	Concluding Steps
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	WP Reference
1. Discuss the results of audit with the supervisory auditor and perform any other audit effort required.	
2. Prepare a memorandum for the record to document the audit results, the key audit procedures applied, and the significant data reviewed. A pro forma memorandum for record (MFR) is included as 17310- Proforma Memorandum for Record. If significant deficiencies or suggestions for improvement are found, note them in the MFR and issue a flash internal control deficiency report or memorandum to the contractor and contracting officer to facilitate immediate corrective action of the deficiencies and implementation of the suggestions. Consider the impact of the deficiencies on the contractor's direct billing status.	
3. Provide copies of the draft MFR, flash internal control deficiency report, and memoranda to, and discuss the results of audit with, the regional Task Force member prior to the exit conference.	
4. Conduct an exit conference with the contractor in accordance with CAM 4-304, including providing the contractor with a copy of the draft MFR, and obtain contractor comments on factual matters such as data accuracy, internal control deficiencies, and suggestions for improvement.	
5. After obtaining the contractor's comments, incorporate them into the MFR, flash billing system report, and memoranda. Copies of the final MFR, billing system report, and memoranda should be provided to the regional Task Force member.	
6. Ensure that the paying office and contracting officer have been notified of any unresolved overpayments, contract administration adjustments, demand letters, and subcontract billings that are over 30 days old; and of any improper offsets. The pro forma memorandum is included as 17310 – Proforma Notification to Payment Office. The memorandum should be addressed to the paying office (joanne.robins@dfas.mil) and sent to the DCAA DFAS Financial Liaison Advisor to be hand delivered/mailed to DFAS. A copy should also be provided to the ACO and the regional Task Force member.	
7. Update the permanent file in accordance with CAM 4-405.1b.	
8. Closing actions should be performed in accordance with FAO procedures. These procedures may require either auditors or administrative personnel to perform various closing steps. Completion of these closing actions should be documented (e.g., by initials and date on the CD or working paper folder, etc.) and should include:	
a. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should be password protected. The electronic file should then be renamed according to the convention "01 DCAA Report [RORG_ASSIGNMENT NO.] – Final.doc" and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes.	
b. Once the report is signed, the signature page of the audit report must be scanned in accordance with Agency standard scanning instructions. For audit packages, the scanned signature page file should be named the same as the audit report (see above) with "-sig" added (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.tif). There is no requirement to make the file a part of the APPS generated executable file and it may be included separately on the CD containing the APPS generated executable file.	
c. Ensure an electronic copy of the final draft audit report containing the	

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<p>supervisory auditor's initials and date on the top page, cross-referenced to the working papers, is included in the working paper package. The final draft report should include all substantive changes made to the original draft, with cross-referencing updated as necessary. It should differ from the final report only due to minor administrative changes (spelling, format, etc.) made during final processing.</p>	
<p>d. Include an electronic version of the acknowledgement letter in the audit working paper package.</p>	
<p>e. Ensure all working paper files are "read only" and, if necessary, compressed for final storage. Generally, current Agency software should be used to automatically modify all electronic files for storage.</p>	
<p>f. Two complete sets of electronic working papers must be prepared. The "original" set should be stored in the working paper package. The "archive" set is to be stored separately from the working paper package on a single session CD-ROM. If there will be a short-term need to access the working papers, a third, or "working" set should be stored so as to be available for reference, generally on the LAN. This set should be deleted when no longer needed.</p>	
<p>g. Verify that electronic files stored on removable media are not corrupted and can be unarchived.</p>	
<p>h. Securely enclose the "original" set of electronic files in the working paper package.</p>	

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MEMORANDUM FOR DEFENSE FINANCE AND ACCOUNTING SERVICE, COLUMBUS CENTER, P.O.
Box 182317, COLUMBUS, OHIO 43218-2317

ATTENTION: BKRD/CC, Joanne Robbins, Chief Debt Management
(E-mail Address: joanne.robbins@dfas.mil)

SUBJECT: Unresolved Contract Overpayment Issues at [Name of Contractor] on
Contract No. XXXXXX-XX-X-XXXX

A recent DCAA audit of contract overpayments at [Name of Contractor] disclosed the following unresolved payment issues. We are bringing these issues to your attention so that you may take whatever actions you deem necessary.

Overpayments That Have Not Yet Been Returned by the Contractor

To the extent known, provide the following information regarding each unreturned overpayment:

- *Amount of overpayment*
- *Date overpayment occurred (Date paid)*
- *Contract number*
- *Contractor voucher or other billing number*
- *Shipment number or Bureau Voucher Number (BVN), if applicable*
- *Date contractor advised ACO and/or paying office of overpayment, if applicable*
- *Person(s) whom the contractor advised of overpayment*
- *Repayment instructions, if any, provided to the contractor by the government*
- *Details on the causes of the overpayment*
- *Reason that the contractor has not refunded the overpayment*
- *Contractor identification:*
 - *Address*
 - *Contractor point of contact and telephone number*
 - *CAGE Code*
 - *Taxpayer Identification Number*
- *Any other relevant information – Attach copies of any information that will assist the paying office to resolve the overpayment, e.g. invoice, DD250, contract modification, contractor payment history, contractor and/or contracting officer correspondence, etc.*

Overpayments Due to Liquidation Differences That Have Not Yet Been Returned by the Contractor

To the extent known, provide the following information regarding each unreturned overpayment:

- *Amount of overpayment*
- *Date overpayment occurred (Date paid)*
- *Contract number*
- *Contractor delivery invoice number and shipment number (DD250)*
- *Date contractor advised ACO and/or paying office of overpayment, if applicable*
- *Person(s) whom the contractor advised of overpayment*
- *Repayment instructions, if any, provided to the contractor by the government*
- *Details on the causes of the overpayment*
 - *Gross billing per contractor records*
 - *Liquidation per contractor records*
 - *Net invoice amount (gross billing less liquidation)*
- *Reason that the contractor has not refunded the overpayment*
- *Contractor identification:*
 - *Address*

- Contractor point of contact and telephone number
- CAGE Code
- Taxpayer Identification Number
- Any other relevant information - Attach copies of any information that will assist the paying office to resolve the overpayment, e.g. invoice, DD250, contract modification showing applicable liquidation rate, contractor payment history, contractor and/or contracting officer correspondence, etc.

Improper Offsets of Overpayments by the Contractor

To the extent known, provide the following information regarding each improper offset:

- Amount of overpayment being offset
- Date overpayment occurred (Date paid)
- Contract number
- Contractor voucher or other billing number of overpayment
- Contractor voucher or other billing number and date where offset was applied
- Shipment number (DD250) or Bureau Voucher Number (BVN)
- Date contractor advised ACO and/or paying office of overpayment and offset, if applicable
- Person(s) whom the contractor advised of overpayment and offset
- Offset instructions, if any, provided to the contractor by the government
- Details on the causes of the overpayment
- Reason that the contractor offset the overpayment
- Contractor identification
 - Address
 - Contractor point of contact and telephone number
 - CAGE Code
 - Taxpayer Identification Number
- Any other relevant information - Attach copies of any information that will assist the paying office to resolve the offset issue, e.g. invoice overpayment, invoice where overpayment was offset, applicable DD250, contractor payment history, contractor and/or contracting officer correspondence, etc.

Contract Administration Adjustments That Have Not Yet Been Returned by the Contractor

To the extent known, provide the following information regarding each unreturned contract administration adjustment:

- Estimated amount of contract administration adjustment
- Date of contract administration adjustment, e.g., date of contract modification
- Contract number(s)
- Date contractor advised ACO and/or paying office of the contract administration adjustment, if applicable
- Person(s) whom the contractor advised of the contract administration adjustment
- Repayment instructions, if any, provided to the contractor by the government
- Details on the causes of the contract administration adjustment
- Reason that the contractor has not refunded the contract administration adjustment
- Contractor identification:
 - Address
 - Contractor point of contact and telephone number
 - CAGE Code
 - Taxpayer Identification Number
- Any other relevant information - Attach copies of any information that will assist the paying office to resolve the contract administration adjustment, e.g. contract modification, details on the estimated impact of the contract administration adjustments, contractor and/or contracting officer correspondence, etc.

Demand Letters Over 30 Days Old That Have Not Been Returned by the Contractor

To the extent known, provide the following information regarding each demand letter not yet processed by the contractor:

- Amount of demand letter
- Date of demand letter
- Bill of Collection Number
- Contract number
- Issuing organization
- Details on the reasons for the demand letter
- Reason that the contractor has not refunded the demand letter amount
- Contractor identification:
 - Address
 - Contractor point of contact and telephone number
 - CAGE Code
 - Taxpayer Identification Number
- Recommendations to the payment office on demand letter amount; e.g., demand letter is valid and the debt should be offset on the next contractor billing submitted to the paying office.
- Any other relevant information - Attach copies of any information that will assist the paying office to resolve the overpayment, e.g., copy of demand letter, contractor's documentation disputing demanded amount, contractor and/or contracting officer correspondence, etc.

Subcontract Overpayments (Included in Billings to the Government) That Have Not Yet Been Returned by the Contractor

To the extent known, provide the following information regarding each unreturned overpayment:

- Amount of overpayment
- Date overpayment occurred (Date paid)
- Contract number
- Subcontractor name
- Subcontract number (if applicable)
- Contractor voucher or other billing number
- Shipment number (DD250) or Bureau Voucher Number (BVN)
- Date contractor advised ACO and/or paying office of overpayment, if applicable
- Person(s) whom the contractor advised of overpayment
- Repayment instructions, if any, provided to the contractor by the government
- Details on the causes of the subcontract overpayment
- Reason that the contractor has not refunded the overpayment
- Contractor identification:
 - Address
 - Contractor point of contact and telephone number
 - CAGE Code
 - Taxpayer Identification Number
- Any other relevant information - Attach copies of any information that will assist the paying office to resolve the overpayment, e.g., invoice, DD250, contract modification, payment history, contractor and/or contracting officer correspondence, etc.

We will be pleased to provide any additional information or auditing services that may be required. Please direct questions to [Name of DCAA contact] at [telephone number] or e-mail at [e-mail address].

[FAO Manager Name]

FAO Manager

Copy Furnished

ACO

Regional Task Force Member

DCAA DFAS FA, Joe Beaumariage



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
CENTRAL REGION
ABC COMPANY RESIDENT OFFICE
123 NEW ROAD
ANY TOWN, USA

3XXX/XXX
(2003A17310001)

(Insert Date)

MEMORANDUM FOR RECORD

SUBJECT: Audit of Contract Overpayments

Audit Objectives:

As part of our comprehensive audit of the [contractor name], we performed an examination of [contractor]'s billing system to determine if adequate procedures and internal controls are in place to accomplish the following objectives:

- Compare billings with cash receipts to identify contract overpayments and ensure amounts due the government are refunded or offset in a timely manner;
- Identify and resolve overpayments due to liquidation differences in a timely manner;
- Reconcile recorded to billed costs to ensure costs are not over billed;
- Identify contract administration adjustments to determine if adjustments are needed to billings and, if so, that they are computed correctly and appropriate refunds or offsets are processed timely;
- Ensure timely and documented responses are prepared in response to demand letters;
- Review contractor's processes for monitoring subcontractor billings and identifying/resolving any overpayments timely;
- Ensure offsets are properly authorized, adequately documented, and applied against billings for previously identified overpayments;
- Ensure refunds are processed in a timely manner; and
- Ensure that there is timely notification to the cognizant paying office and contracting officer of significant overpayments.

We reviewed contractor documents and records related to its billing system and related internal controls, including *(tailored as appropriate)*:

- accounts receivable aging reports,
- accounts payable aging reports,
- payment variance accounts and exception reports showing results of the comparisons between billed amounts and cash receipts,
- reports showing progress payment requested amounts, delivery invoice amounts, progress payment liquidations, and net delivery invoice amounts,
- reconciliations of billed and booked costs,
- reports showing the payment status of all significant contracts,
- reports listing refunds made to the government,
- individual billings and checks submitted to the government,

- contract offset reports,
- reports showing the status of contract administration adjustments and the computations of those adjustments,
- contract modifications and other source documentation relating to contract administration adjustments,
- demand letters,
- contractor status reports on demand letters and the responses to demand letters, and
- subcontract administration reports and documentation.

Background Information:

[Contractor]'s annual total sales (*or total sales for latest fiscal year*) are approximately \$XXX million, including \$XXX of DoD sales and \$XXX of government sales. The contractor's fiscal year (FY) 2003 ADV is approximately \$XXX million. Billings on DoD contracts and subcontracts for the period XX to XXX, 2002, were \$XXX, including \$XX on progress payments/delivery invoices, \$XX on public vouchers (cost-type), and \$XX of other billings (*describe if significant*).

The contractor's primary product lines are XXXXX (*describe top 3-5*). Its major government customers are XXX (*describe top 3-5*).

Audit Results:

Comparison of Billed and Paid Amounts

As of XXX, 2003, the contractor had XX outstanding overpayments totaling over \$XXX million. The contractor has adequate procedures for comparing billings with cash receipts. (*Describe the contractor's reports that provide details on differences between billed and paid costs*).

The contractor has adequate procedures for accounting for liquidations on delivery invoices. (*Describe contractor's procedures for accounting for liquidations, including any differences in liquidations taken by the contractor versus the paying office.*)

The contractor does not have adequate procedures for resolving payment variances in a timely manner. We sampled all overpayments over \$XX to examine the contractor's procedures for identifying and resolving overpayments. Our sample included XX overpayments totaling over \$XXX million. Our examination found that XX overpayments totaling \$XX million have not been refunded either by check or offset.

Attachment 1 includes details on the XX overpayments that are outstanding over 30 days and are still outstanding as of (*date of most recent available data*). (*Attach schedule showing the details for each overpayment – overpayment amount, invoice date, overpayment date, number of days overpayment outstanding, and reason for the overpayment.*)

We issued memorandums to the Defense Finance and Accounting Service (DFAS) providing details on each of the overpayments still outstanding over 30 days for the purpose of assisting DFAS in collecting the overpayments. (*If memorandums were not issued to DFAS explain why.*)

The contractor needs to establish procedures and internal controls to ensure that overpayments are resolved within 30 days after receipt of the overpayment.

Reconciliation of Recorded to Billed Costs

The contractor's procedures for reconciling recorded costs to billed costs need improvement. The contractor does not periodically reconcile recorded and billed costs on physically complete (but not yet closed)

contracts. We identified XX contracts that were overpaid by \$XXX,XXX because the contractor did not reconcile recorded and billed costs to identify contracts that were in an overpaid status as a result of downward adjustment to recorded costs (*Briefly explain the reason(s) for significant adjustments.*) Attachment 2 lists the contracts that are in an overpaid status because billed costs are greater than recorded costs. We coordinated with the contractor and the contracting officer to get the contractor to submit revised billings to return the overpayments. As of (*Date*), all revised billings for these contracts have been processed.

The contractor needs to establish procedures and internal controls ensuring that reconciliations of billed and recorded costs are performed on a periodic basis for all contracts (including physically complete contracts awaiting closeout); and revised billings and refunds are submitted timely when billed costs exceed recorded costs.

Contract Administration Adjustments

The contractor's procedures for processing and documenting contract administration adjustments need improvement. (*Briefly describe the contractor's procedures for processing contract administration adjustments.*). During the period XXX to XXX, 2003 (*12 month period of review of contract administration adjustments*), we found that the contractor took an average of over XX days to process contract administration adjustments. We also found that the contractor took over a year to process X contract administration adjustments that resulted in over \$XX million of refunds or offsets to the government. As of (*date of most recent available data*), the contractor has not processed X contract administration adjustments that will result in estimated refunds or offsets to the government of over \$XX million.

The primary reasons for the contract administration adjustments during the last 12 months period ending XXX, XX 2003 were (*identify Top 3-5 reasons*). Attachment 3 includes details on the outstanding contract administration adjustments and those adjustments that took more than 30 days to process (*attach schedule showing the details for each adjustment – the reason for the adjustment, the estimated amount of the contract administration adjustment, the date of the contract modification, the period of time the adjustment has been outstanding, etc.*)

We issued memoranda to DFAS providing details on each of the outstanding contract administration adjustments to assist DFAS in collecting the refunds or processing the offsets. (*If memorandums were not issued to DFAS explain why.*) The contractor needs to establish procedures and internal controls ensuring that contract administration adjustments are processed within 30 days after the date of the contract modification.

Demand Letters

The contractor's procedures for processing demand letters for payment need improvement. During the period XXX to XXX, 2003 (*12 month period of review of demand letters*), the contractor received XX demand letters from DFAS and the contracting officer demanding payment of \$XX million. The contractor responded to X of the demand letters on the average of XX days after receipt of the letter and provided \$XX million of payments. The contractor has not yet responded to X of the demand letters requesting payments of \$XX million. These demand letters were dated X to X months ago. Attachment 4 includes details on the demand letters that are currently outstanding and those that took more than 30 days to process (*attach schedule showing details on the demand letters – date of letter, period outstanding, demand letter amount, reason for the demand letter, etc.*)

We issued memoranda to DFAS providing details on the payment issues described in the demand letters for the purpose of assisting DFAS in resolving the payments. The contractor needs to establish procedures and internal controls to ensure that demand letters are responded to (and include required payments of any undisputed amounts) within 30 days after the letters are received.

Subcontractor Billings

The contractor's procedures for monitoring subcontractor billings need improvement. During the period XXX to XXX, 2003 (*12 month period of review of subcontractor billings*), we found that the contractor's major subcontracts were with Subcompany 1, Subcompany 2, and Subcompany 3. Our review found that the contractor's procedures for obtaining information on the adequacy of the subcontractors' billing and accounting systems and subcontractors' reconciliations of billed and paid amounts need improvement. As a result, we requested assist audits on these subcontracts.

The assist audits found that Subcompany 2 and Subcompany 3 have been overpaid by \$XX million. These overpayments were included, by the prime contractor, in billings to the government. Attachment 5 includes details on these subcontractor overpayments that have not been resolved. We also issued memorandums to DFAS providing details on each of these subcontractor overpayments for the purpose of assisting DFAS in collecting the \$XX million.

The contractor needs to establish procedures and internal controls ensuring that contract administration adjustments impacting subcontractor billings are processed timely, and that comparisons of subcontractor billings and payments are performed to provide for timely resolution of subcontractor overpayments.

Offsets

The contractor's procedures for processing offsets need improvement. During the period XXX to XXX, 2003 (*12 month period of review of offsets*), we found that the contractor processed XX contract offset adjustments totaling over \$XX million by reducing current requests for payment on contract billings without obtaining and/or documenting prior approval from DFAS or the contracting officer. Attachment 6 includes details for each of the offsets that lacked adequate documentation and prior approval (*attach schedule showing the details of the offsets – dates of the offsets, offset amount, reason for the offset, why documentation was considered inadequate, etc.*).

We issued memoranda to DFAS providing details on each of these offsets for the purpose of assisting DFAS in determining if the offsets were proper. (*If memorandums were not issued to DFAS explain why.*)

The contractor needs to ensure that prior approval is obtained before making any contract offsets, and that adequate documentation is maintained on all contract offsets.

Refunds

The contractor's procedures for processing refunds need improvement. During the period XXX to XXX, 2003 (*12 month period of review of refunds*), we found that the contractor processed XX refunds to government paying offices totaling over \$XX million. We reconciled the 12 month refund data to the refunds identified during the review of billed and paid amounts, reconciliation of recorded and billed costs, contract administration adjustments, demand letters, and subcontractor billings. The primary reasons for the refunds are (*identify the top 3-5 reasons for refunds and the related dollar amounts*). Attachment 7 includes details of refunds that took more than 30 days to process (*attach schedule showing the details – date of the action requiring refund, date of refund, refund amount, reason for the refund.*)

Internal Control Deficiencies, Suggestions for Improvement, and Contractor Reaction

(*Summarize any internal control deficiency or suggestion for improvement.*) On XXX, we issued a flash billing system report describing the above conditions and providing recommendations to improve the billing procedures and related internal controls. (*Or on XXX, we issued a memorandum to the contractor and contracting officer providing suggestions for improvement to the contractor's billing system.*)

The contractor stated the recommendations will be implemented by XXX, 2003. We will follow-up on the contractor's corrective actions within 90 days.

We provided the draft MFR and discussed the results of our audit with Mr. John Doe, ABC Company Controller, in an exit conference held on XXXX XX, 2003. The contractor concurs with the audit results and agreed to develop corrective actions addressing the deficiencies and suggestions for improvement. The contractor's formal response is attached.

Resident Auditor
ABC Company Resident Office

Attachments:

1. Schedule of Overpayments
2. Schedule of Contracts with Billed Costs Greater Than Recorded Costs
3. Schedule of Contract Administration Adjustments
4. Schedule of Demand Letters
5. Schedule of Unresolved Subcontractor Overpayments
6. Schedule of Offsets Without Adequate Documentation/Approval
7. Schedule of Refunds



DEFENSE CONTRACT AUDIT AGENCY
CENTRAL REGION
ABC COMPANY RESIDENT OFFICE
ANY TOWN, USA

IN REPLY REFER TO

xxxx-2003x17310xxx

(date)

MEMORANDUM FOR FAO MANAGER, (FAO NAME)

SUBJECT: Audit of Contract Overpayments
 (Subcontractor Name (short name))

As part of our continued audit coverage of (prime contractor name, city, state) billing system procedures and internal controls for identifying and resolving contract overpayments, we have identified (subcontractor short name) as a major subcontractor of (prime contractor name). A listing of our identified subcontract nos., period of performance, price, and contract type for (prime contractor name) is included as an attachment to this assist audit request.

We request your assistance in obtaining the following information on the attached subcontracts.

- DCAA's current assessment of the adequacy of (subcontractor short name's) accounting and billing systems for submitting subcontractor billings to (Prime Contractor Name);
- listing and supporting details on all current outstanding overpayments; and
- listing and supporting details on all current outstanding (prime) contract administration adjustments that impact (subcontractor short name) billings.

Please provide the requested information by (date). Direct any questions regarding this request to (Name), Supervisory Auditor, at (Phone No.) or (Name), Senior Auditor at (Phone No.), our FAX is (Phone No.). Our e-mail address is dcaa-faoxxx@dcaa.mil.

Resident Auditor
DCAA (FAO Name)

Attachment:

(1) Subcontract Listing