Audit procedures for consultant

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General

The following guidelines should be considered when developing specific audit procedures for consultant overhead rate audits.

Labor Costs

In the majority of consultant contracts labor is the largest single component of cost.

This component is made up of direct labor charges to the contract and indirect labor charges allocated to the contract through a factor or rate.

Once this assessment has been made the auditor can determine the size and depth of the audit sample for labor testing.

1. The labor sample should be tracked from employee time records to:
   - The payroll records to assure hours recorded are paid.
   - The cost system to assure hours are posted properly to jobs.
   - The general ledger to assure that the total posted is recorded in the financial accounting system.
2. The overall labor in general ledger accounts should be reconciled to:
   - The job cost system
   - The payroll reports submitted to the Internal Revenue Service (i.e. 941's).
3. Audit procedures should also determine if the labor accounts and individual time card entries sufficiently screen labor to:
   - Determine the allowability of payroll cost. (i.e. Do the records separate excess compensation and time spent on **unallowable** activities?)
   - Determine the proper allocation of labor. (i.e. Do the records charge all labor performed on similar tasks the same way?)

- Determine if labor is posted in a manner from which the labor base can be computed. (i.e. If the base is direct labor without premium overtime do the records accumulate direct labor and direct premium overtime?)

Allocated Costs

Cost centers are developed to capture costs associated with a single purpose. The costs are assigned to objectives based on unit charges. Examples of categories for individual cost centers are printing, computers and vehicles. The over/under

allocation of costs is usually handled as an adjustment to the overhead pool, which is where the cost would have been charged if it had not been directed to the cost center. If the over/under allocation is significant, consideration should be given to adjusting the contract charges.

Some accounting systems will attempt to adjust the unit charge rate for the over/under allocation of the cost centers. The goal of any cost center is to minimize the over/under allocation by the application of a properly estimated unit charge.

Audit issues of particular concern are:

1. Costs posted to the center are properly **allocable**. *Do the costs belong to the function being priced?*

2. Costs posted to the center are **allowable**. *Do the costs exclude interest, profit or other costs excluded under the FARs?*

3. The unit charge records indicate the consistent assignment of all similar charges to projects.

Item three is the one most often overlooked by firms and can result in substantial adjustments. Some firms do not choose to set up cost centers. These firms estimate the cost of providing certain services by pulling just certain elements from ledger accounts (i.e.automobile depreciation from a general ledger depreciation account). Once established, these unit charges are offset to overhead as they are utilized on projects. This type of costing is less precise and should not be utilized if the unit charges being accumulated are significant to the firm’s overall operation.

Other Direct Costs

Invoices received from vendors or employees support these costs. They are processed through the cost accounting system and assigned directly to a project.

The costs are not included in the overhead pool. Direct accounts should be established in the General Ledger and all similar costs should be posted to the accounts. Some examples are: project travel, vendor printing, employee mileage, rented vehicles and equipment, and subcontracts.

The audit procedures for these costs concentrate in two areas. The first area is the direct cost accounts themselves. The procedures are:

- Determine if costs are posted to the proper account and assigned to the correct projects.
- Determine if the costs are **allowable** in accordance with the contract and FARs.

The second area would concentrate on the overhead accounts. The accounts tested would be the ones similar in nature of cost to those charged to the direct accounts.

The main audit efforts should be concentrated on:

- Determine if costs are consistently allocated to projects when they are incurred for similar purposes.
- Determine if costs are priced consistently to direct and indirect cost objectives.

Other Audit Procedures

Specific additional audit procedures are dependent upon the individual firm being audited. Certain audit steps that may be required for one firm are not necessary for
another.

Several of these areas can be identified by a comprehensive preliminary review of the following information:

1. A detailed overhead rate schedule is needed to assure the auditee has separated **unallowable costs** as required by FARs.
2. An accounting and control survey is needed which will answer questions about possible areas of concern. Examples are:

- Gains or losses on assets
- Personal use of autos
- Transactions with common control entities
- Bonus plans
- Direct costing policies
- Acquisitions and re-structuring
- Depreciation schedules

3. A tax return prepared for the fiscal year(s) being audited. Many areas addressed in the return are of concern to the Internal Revenue Service as well as for government contracting.
4. A disclosure statement (required by Cost Accounting Standards) when federal contracts exceed a given amount as follows:
- $25 million per single contract, or
- $25 million in CAS-covered contracts with at least one single award exceeding
$1 million
http://www.bkaudit.ru/audit_en.html