Most Frequent Issues With

CPA Workpaper Reviews of Indirect Cost Rate Audits

The keys to establishing a Federal Acquisition Regulation (FAR) compliant Indirect Cost Rate (ICR) and to performing a successful audit of an A&E firm's ICR, is for the A&E firm and CPA to become familiar with, and to follow, the American Association of State Highway Officials Uniform Audit & Accounting Guide (AASHTO Audit Guide). See specifically the review program, Appendix A of the AASHTO Audit Guide. This review program is used extensively during the reviews of CPA's workpapers to the ICR audits of A&E firms.

Note: A CPA's Failure to follow Generally Accepted Government Auditing Standards (GAGAS) and the AASHTO Audit Guide can result in an ICR being rejected, recommendation to significantly reduce an ICR, disallowance of costs; and in extreme cases, referring the CPA to the appropriate Board of Accountancy for review.

The goal here is to help both the A&E and CPA firms be successful in developing or auditing A&E firms' ICRs.

Frequently identified issues with A&E firms encountered during CPA workpaper reviews:

- A&E firms are not always requiring the CPA firms to follow GAGAS and the AASHTO Audit Guide when conducting the ICR Audit. A&E firms should require that a reference to GAGAS and the AASHTO Audit Guide be incorporated into the engagement letter between the A&E and CPA firms. A&E firms should be diligent in considering, but not limited to, the following when selecting a CPA to perform their ICR audits:
    - The CPA should meet all GAGAS requirements, including the requirement for adequate continuing professional education in government auditing.
    - The CPA should be well versed in GAGAS, the provisions of FAR Part 31 (including the FAR Subpart 31.2 cost principles), Cost Accounting Standards, related laws and regulations (e.g., the Internal Revenue Code, The Federal Travel Regulations, and 23 U.S.C. 112), and the guidelines and recommendations set forth in the AASHTO Audit Guide.
    - The CPA should have a working knowledge of the A&E industry, including common operating practices, trends, and risk factors. Preferably, the CPA would have prior experience conducting ICR Audits for A&E firms.
    - The CPA should be well versed in job-cost accounting practices and systems used by A&E firms.
- A&E firms are not ensuring their (project) job cost systems, are adequate to segregate reasonable, allowable and allocate project costs. A properly designed system should include, but not be limited to:
    - Proper segregation of direct, indirect, and unallowable costs.
    - Identification and accumulation of direct costs by cost objective/contract.

- A logical and consistent method for allocating indirect costs to intermediate and final cost objectives.
- Accumulation of costs under general ledger control.
- A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.
- Interim (at least monthly) determination of costs charged to contracts through routine posting to books of account.
- Exclusion from costs charged to Government contracts of amounts that are not allowable pursuant to FAR Part 31 or other contract provisions.

- A&E firms do not always have adequate procedures in place over their labor charging system and processes:
  - Procedures should require ALL employees (both hourly and salaried) to record ALL hours worked; including the hours that exceed 40-hours in a work week, whether they are paid or unpaid. Firms should be prepared to demonstrate how they account for uncompensated overtime for ALL employees, including executive management, and its impact on the ICR.
  - The job cost systems are not always set-up properly to ensure proper distribution of labor costs. This is necessary because labor rates and labor indirect costs can be affected by total hours worked, not just paid hours worked.
  - The job cost system should be reconciled to the general ledger on a regular basis. This reconciliation should occur no less frequently than once every 30 days.
- A&E firms must complete and properly document the work performed for their Executive Compensation Analysis. Simply using the benchmark amount, or simply using the National Compensation Matrix without documenting the work is not adequate. The key is to document the work performed to substantiate the amount of Executive Compensation deemed allowable and make adjustments to the ICR as necessary.
- A&E firms sometimes choose not to create cost centers and instead, estimate the cost of providing certain services by computing in-house unit rates based on certain elements from general ledger accounts (e.g., vehicle (mileage) rates, printing, computers, etc.) Once established, these unit charges should be offset to the indirect expense pool as “credit backs” or cost recoveries for allocated direct costs as they are utilized on projects. For example, vehicle (mileage) rates should be supported by vehicle logs showing direct and indirect usage. When handled on a direct cost basis, the direct cost rates must be supported and **“audited”.**

Frequently identified issues with CPA firms discovered during CPA workpaper reviews:

Note: It is very important to be aware that when state and federal funds are involved there is a much higher level of scrutiny, the materiality levels should be lower, and more testing is required. As such, these ICR audits are not typical ‘business as usual’ audit.

- Difficulty accessing CPA's workpapers. **Full access to the CPA's workpapers to a state or federal government official is a contract requirement**.
- Inaccessibility of CPAs or delays in responding to auditors.
- Overall lack of documentation
    - Why steps were excluded
    - Clear and complete description of analysis
    - How conclusions were reached
- The Audit Program is not appropriate or specifically tailored to perform Indirect Cost Rate Audits (e.g. the usage of the Practitioners Publishing Company Accounting & Auditing guide for financial statement audits).
- Labor Cost Testing does not always meet minimum recommended testing procedures presented in the AASHTO Audit Guide, Ch.10.3. It is recommended that *all* transactions on 26 timesheets are tested. If fewer than *all* transactions on 26 timesheets are tested sound justification must be documented.
- Lack of documentation by the CPA addressing the consultant's accounting treatment of uncompensated overtime and premium overtime.
- Indirect expense testing does not always meet minimum recommended testing procedures presented in AASHTO Audit Guide, Ch.10.4.
    - No documentation supporting compliance with cost principles of FAR 31.2 (i.e. 31.201-2 Determining Allowability, 31.201-3 Determining Reasonableness, and 31.201-4 Determining Allocability).
    - No documentation supporting assurance on general financial statement assertions (occurrence, completeness, accuracy, authorization, cutoff, and classification).
    - No documentation supporting Large Dollar or Sensitive (LDS) transactions testing.
    - No justification for not examining accounts determined to be high risk per AASHTO Audit Guide Ch. 10.4.B.
- Job Costing System: Lack of evidence to support that the CPA audited this area to determine if the A&E firm's system accounts for all direct costs (direct labor and other costs that can be identified with a project or final cost objective).
- Other Direct Costs (ODCs): Lack of support in the CPA's workpapers to ensure they audited ODCs for consistency of accounting treatment.
- No documentation on the evaluation of Internal Controls relating to the accounting, project costing and the related labor charging systems (AASHTO Audit Guide Ch.6.4.A, Ch.6.4.B and Ch.9.3A).
- The workpapers do not always disclose a complete review of the Minimum Audit Report disclosure notes, to ensure that they are consistent with the requirements in the AASHTO Audit Guide, Ch. 11.4.
- Documentation does not support that lower levels of materiality were used as compared with non GAGAS audits in accordance with the "public accountability" principle of GAGAS 4.47.

- Proper documentation substantiating their review and conclusion that the consulting firm performed an Executive Compensation analysis in accordance with the AASHTO Audit Guide, Ch. 7.
- No documentation in the workpapers to support that in-house direct cost rates, if any, were audited to ensure that the A&E firm properly developed the rates, and that the costs associated with the in-house direct cost rates that remain in the indirect expense pool represent indirect usage only.

Resources:

23 CFR Part 172

AASHTO Uniform Audit & Accounting Guide

National Highway Institute (NHI) Training

FHWA-NHI-231028: Using the AASHTO Audit Guide for the Procurement and Administration of A/E Contracts

FHWA-NHI-231029: Using the AASHTO Audit Guide for the Development of A/E Consultant Indirect Cost Rates

FHWA-NHI-231030: Using the AASHTO Audit Guide for the Auditing and Oversight of A/E Consultant Indirect Cost Rates

FHWA Frequent Questions and Answers

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