

**Accounting System Deficiencies Found During  
Incurred Cost Audit**

**March 2005**

**Reference Number: 2005-1C-033**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 16, 2005

MEMORANDUM FOR DAVID A. GRANT  
DIRECTOR OF PROCUREMENT  
INTERNAL REVENUE SERVICE

*Daniel R. Devlin*

FROM: Daniel R. Devlin  
Assistant Inspector General for Audit (Headquarters Operations  
and Exempt Organizations Programs)

SUBJECT: Accounting System Deficiencies Found During Incurred Cost  
Audit (Audit #20051C0206)

The Defense Contract Audit Agency (DCAA) audited the contractor's Federal Sector incurred costs. The audit included determining whether the contractor consistently complies with established accounting system internal controls for recording and reporting contract cost data for the Federal Government contracts. The DCAA stated that consistent application of sound accounting procedures should reduce errors in contract cost data, reduce the amount of manual processing of invoices for billing, reduce the errors in computing indirect rates, and facilitate the audit and evaluation of contract costs.

The DCAA evaluation was limited to certain contractor accounting practices used in recording contract cost data. The DCAA did not perform sufficient audit procedures to constitute an examination of all applicable accounting system internal controls, in accordance with generally accepted *Government Auditing Standards*.

The DCAA opined that certain contractor accounting practices used for recording and reporting contract cost data in connection with the contractor's incurred cost submissions require corrective actions to improve the reliability of claimed contract costs. Specifically, the DCAA indicated the contractor lacks adequate Interdivisional Work Order (IWO) agreements, lacks adequate supporting data and descriptions for adjusting journal entries, and has inadequate recording of corporate allocations.

During the examination of the Civil Division's Fiscal Year (FY) 2001 incurred cost submission, the DCAA identified \$3,176,405 of claimed IWO costs that did not have an IWO agreement and \$151,549 that had IWO agreements but lacked an adequate description of the nature of the work performed on Federal Government contracts. During the audit of the Civil Home Office's FY 2002 incurred cost submission, the DCAA questioned claimed costs because the contractor did not provide adequate supporting documentation for 83 of the 109 transactions selected for the review. In addition, because the documentation provided did not contain adequate information from which to determine whether the adjusting journal entries were reasonable and in compliance with applicable Cost Accounting Standards (CAS), the Federal Acquisition Regulation (FAR), and the terms of the Federal Government contracts, the DCAA stated that the claimed direct and indirect costs may be materially misstated. The DCAA also stated that the descriptions of the adjusting journal entries were vague and confusing, and, as a result, it was unable to determine if they were necessary, reasonable, and in compliance with applicable CAS and FAR provisions.

Additionally, the contractor does not have a process to properly identify and record in its general ledger the corporate allocations received. The corporate allocations are included in the incurred cost claims of the Federal Sector and its operating segments. Consequently, the contractor was unable to timely reconcile the claimed corporate allocations to the benefiting corporate segments.

The DCAA recommended the contractor establish and implement policies and procedures that provide for adequate preparation, execution, documentation, authorization, and recordkeeping of IWO agreements; maintain adequate supporting documentation for each adjusting journal entry; use adequate descriptions in its Cost Point accounting system for all adjusting journal entries; and provide proper identification and recording of higher-tier allocations.

The information in this report should not be used for purposes other than those intended without prior consultation with the Treasury Inspector General for Tax Administration regarding their applicability.

If you have any questions, please contact me at (202) 622-8500 or John R. Wright, Director, at (202) 927-7077.

Attachment

# NOTICE:

The Office of Inspector General for Tax Administration has no objection to the release of this report, at the discretion of the contracting officer, to duly authorized representatives of the contractor.

The contractor information contained in this report is proprietary information. The restrictions of 18 U.S.C. § 1905 must be followed in releasing any information to the public.

This report may not be released without the approval of this office, except to an agency requesting the report for use in negotiating or administering a contract with the contractor.

*The TIGTA seal was removed due to its size.*