

Master Document – Audit Program

Activity Code 13500		Major Contractors Labor Floor Checks or Interviews
Version 4.4, dated November 2009		
B-1	Planning Considerations	
Purpose and Scope		
<p>The purpose of this evaluation is to evaluate the accuracy of contractor employee (salaried and/or hourly) labor hour charges to contracts, indirect accounts, or other cost objectives. When properly tailored and approved by the supervisory auditor, this program can be used to perform labor floor checks and interviews to help satisfy the mandatory annual audit requirement relating to labor floor checks and/or interviews. (MAAR 6)</p>		
<p>While labor interviews and floor checks are similar, they vary in the nature and extent of procedures used. The type of procedures used is influenced by the perceived risk associated with the recording and accumulation of labor costs. In particular, the control risk associated with the contractor's labor accounting system and related internal controls will have a significant impact on the type of procedures considered necessary. In all circumstances, effective and productive audits will require some physical verification of labor transactions (interviews/floor checks) to arrive at supportable conclusions regarding the acceptability of labor costs charged to Government contracts. The objectives of labor interviews are to evaluate the accuracy of contractor employee (salaried and/or hourly) labor hour charges to contracts, indirect accounts, or other cost objectives. The objectives of floor checks are to verify the existence of employees and to evaluate the timekeeping internal control procedures.</p>		
<p>The extent of audit effort in testing and verifying labor costs is dependent on the perceived audit risk and is influenced by (1) the nature and significance of labor and related expenses, (2) prior audit experience with the contractor, (3) the reliability and acceptability of the contractor's labor system and related internal controls, (4) the contractor's mix of contracts and nature of contract provisions, and (5) the nature of the contractor's organization and operations.</p>		
<p>It would be impractical with limited resources to analyze all labor costs at one time. The audit steps in the Risk Assessment (Section B-1), Conditions Influencing Labor Charging Practices (Section C-1), Determining Additional Audit Effort (Section D-1), and Pre-Interview Analysis (Section E-1) will help identify those areas most likely to result in a significant adverse cost impact to the Government (risk) and the extent of Government exposure to suspected irregular conduct (vulnerability). The nature and extent of further audit effort should be based on the outcome of this risk and vulnerability analysis. All information gathered must be analyzed in relation to all other contractor knowledge obtained during the evaluation.</p>		
<p>This program contains audit steps that will help satisfy all or part of the following mandatory annual audit requirements (MAARs):</p>		
1.	MAAR 1 - Internal Control Audit Planning Summary (ICAPS) and/or Internal Control Questionnaire (ICQ)	

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2.	MAAR 3 - Permanent Files
3.	MAAR 6 - Labor Floor Checks or Interviews.
4.	MAAR 7 - Changes in Charging Direct/Indirect Costs
5.	MAAR 8 - Comparative Analysis - Sensitive Labor Accounts
6.	MAAR 9 - Payroll/Labor Distribution Reconciliation and Tracing
7.	MAAR 10 - Adjusting Entries and Exception Reports
8.	MAAR 12 - Auditable Subcontracts/Assist Audits
9.	MAAR 15 - Indirect Cost Comparison with Prior Years and Budgets
References	
1.	CAM 6-400 - Audit of Incurred Labor Costs
2.	CAM 6-800 - Assist Audits of Incurred Costs
3.	CAM 10-400 - Audit Reports on Operations and Internal Control (Systems Audits)
4.	CAM 10-808 - Audit Reports on Noncompliance with Disclosed or Established Practices, CAS, or FAR (Noncompliance Reports)
5.	CAM 4-702.3 - Fraud Indicators and Audit Procedures for Uncovering Fraud
6.	CAM Figure 4-7-3 - Examples of Characteristics and Types of Activity Associated with Illegal Expenditures and Acts for Specific Audit Areas

B-1	Preliminary Steps	W/P Reference
Version 4.4, dated November 2009		
1.	Read CAM 6-404.3.	
2.	Evaluate the labor ICAPS or ICQ (for non-major contractors) and related section of the contractor's permanent file to obtain an understanding of the contractor's labor accounting policies, procedures, and the level of control risk associated with the related internal controls. Contractor organization charts, labor charging and distribution system flowcharts, and listings of current Government contracts are very useful sources of information and should be referred to often during the analysis. All relevant information gathered during the audit should be referenced in the permanent file. (MAAR 3)	
3.	If the contractor is classified as non-major (where ICAPS have not been completed) and if the evidential matter to be obtained during the	

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audit is highly dependent on computerized information systems, document on W/P B-2 the audit work performed that supports reliance on the computer-based evidential matter. Specifically, document or reference one or more of the following in W/P B-2:	
a. The audit assignment(s) where the reliability of the data was sufficiently established in other DCAA audits,	
b. The procedures/tests that will be performed in this audit to evaluate the incurred costs that will also support reliance on the evidential matter, and/or	
c. The tests that will be performed in this audit that will be specifically designed to test the reliability of the computer-based data.	
When sufficient work is not performed to determine reliability (i.e., reduce audit risk to an acceptable level), qualify the audit report in accordance with CAM 10-210.4 and 10-504.4.	
4. Coordinate the evaluation with the ACO and other contracting officer representatives as discussed in CAM 6-404.3b. If the work is technical in nature such that the auditor might be unable to determine whether the employee is performing the effort being charged, consider requesting technical assistance.	
5. On an annual basis or during the first visit to the contractor, hold an entrance conference with the appropriate contractor representative(s) to exchange preliminary information about the audit and to enable the contractor to provide a briefing about its labor charging and allocation policies.	
a. Obtain an understanding of the contractor’s timekeeping procedures and document the process.	
(1) Determine whether employee attendance is controlled by clock cards, timecards, other suitable time and attendance records, or are input and captured electronically.	
(2) Identify the process for controlling employee time records at each timekeeping station, or the electronic timekeeping input and related records.	
(3) Determine the procedures for notifying the employee of the assigned job number and whether the procedures provide that all changes are properly initialed/approved by the employee and the designated approving supervisor.	
(4) Determine whether hours shown on the timecards or input electronically are reconciled periodically with hours recorded on attendance and payroll records.	

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<p>(5) Determine whether there is a division of responsibility within the company between personnel responsible for the preparation and/or approval of time and attendance records and those responsible for preparation and distribution of payroll. Ensure a proper division of responsibility exists within the payroll department (CAM 6-406.2(10)).</p>	
<p>(6) Determine whether there is a division of responsibility between personnel having a part in the preparation of time and attendance records and those responsible for operating within budgets. If a division of responsibility does not exist, there is an increased risk of affecting payroll in proportion to the number of personnel the employee/manager can influence.</p>	
<p>(7) Determine whether procedures have been established for coding and recording idle time.</p>	
<p>(8) Determine whether records of piece work and work performed under wage incentive plans are checked and controlled independently from production counts, approvals for allowances, and other operations.</p>	
<p>b. Discuss the general time period of audit performance.</p>	
<p>c. Advise the contractor that the evaluation will include unannounced interviews or floor checks.</p>	
<p>d. Request the contractor designate a representative and an alternate to accompany the audit team during the interviews or floor checks. A representative and alternate should be designated for each of the contractor's locations.</p>	
<p>e. Establish procedures for conducting interviews or floor checks. Inform the contractor that documentation will be requested from the employee during the interview or floor check to support the labor effort being charged/allocated to the Government.</p>	
<p>f. Request the contractor to provide a representative to coordinate the audit and for discussing audit progress and findings.</p>	
<p>6. Request and evaluate the contractor's internal audits of labor, which may include floor checks and reviews of labor charging and allocation practices, policies, and procedures. Document any reported deficiencies and corrective actions recommended and/or taken by the contractor. Determine the extent to which we can rely on the work performed (see CAM 4-1000).</p>	

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<p>7. In planning and performing the evaluation, consider the fraud risk indicators specific to the audit. The principal sources for the applicable fraud risk indicators are:</p> <ul style="list-style-type: none"> • Handbook on Fraud Indicators for Contract Auditors, Section II.1. (IGDH 7600.3, APO March 31, 1993) located at http://www.dodig.mil/PUBS/igdh7600.doc (To access the handbook, copy and paste the web address shown above into the address block in Internet Explorer.) • CAM 6-404.6b, 6-404.8a and CAM 4-7-3. <p>Document in W/P B any identified fraud risk indicators and your response/actions to the identified risks (either individually or in combination). This should be done at the planning stage of the evaluation, as well as during the evaluation if risk indicators are disclosed. If no risk indicators are identified, document this in W/P B.</p>	
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C-1	Conditions Influencing Labor Charging Practices	W/P Reference
Version 4.4, dated November 2009		
<p>Note: Proper risk and vulnerability analysis requires a working knowledge of not only the contractor's operations, policies, and procedures, but also of the many conditions that may influence management decisions. Labor risk and vulnerability are usually the affect of the relationships among several conditions. The evaluation of the following factors and conditions may identify risk areas, e.g., cost/profit centers, departments, groups of employees, employee labor classifications, or contract/cost objectives where the potential for labor mischarging is high. The auditor should identify the specific risk area(s) associated with these conditions.</p>		
1. Read CAM 6-404.6.		
2. Determine the Government contract mix (cost vs. fixed price/commercial). A contractor with a mix of cost-type and fixed-price/commercial work may be tempted to mischarge effort allocable to fixed-price or commercial work to cost reimbursable work.		
3. For Time and Material (T&M) contracts, perform a profit margin test by comparing the booked (actual costs) to billed costs. If differences between actual costs and billed costs are significant, analyze further to determine the cause for the differences (indirect rates or labor rates).		
a. If variances in the labor rates are the cause for the differences, assess the risk that the contractor is substituting less qualified employees. If substitution is occurring, include those employees		

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performing on these contracts for detailed employee interviews.	
b. If variances in the indirect rates are the cause for the differences, prepare an audit lead sheet for this issue to be addressed in an estimating system or post award audit.	
4. Perform labor cost trend analyses.	
a. Perform trend analyses to disclose any significant increases in the ratio of direct to indirect labor accounts. Significant fluctuations in the ratio of direct to indirect costs should be explained. If there is no apparent explanation, this area should be further evaluated (e.g., the contractor may be misclassifying direct contract costs to selling and marketing costs or IR&D/B&P costs). (MAARs 7, 8, and 15)	
b. Evaluate changes in procedures and practices for direct/indirect time charging of contractor employees for consistency with GAAP, CAS, and applicable contract cost principles. (MAAR 7)	
c. Perform a comparative analysis of sensitive labor accounts. Significant fluctuations should be explained. Be alert to situations where labor is being excluded from overhead allocation bases or transferred from the allocation base to the indirect cost pool. (MAAR 8)	
5. Analyze the contractor's organizational structure to determine if it permits inconsistent treatment of similar labor costs. Determine whether the treatment of labor costs associated with program management, secretarial and administration, employee training, meetings, and downtime is consistent.	
6. Scan adjusting journal entries and labor transfers. (MAAR 10) Determine if there are any unusual labor transfers made via adjusting journal entries and whether adequate rationale and supporting documentation is available. Be alert to situations where labor costs are being transferred without supporting timecards and/or documentation. Seek explanations for any abnormal adjusting entries or corrections.	
7. Request the contractor to provide a listing of all contracts that are currently in an overrun position or projected to be in an overrun position. Labor effort associated with contracts at or near an overrun position is more likely to be mischarged.	
8. Request the ACO to identify any contracts considered at or near overrun or otherwise candidates for potential labor mischarging.	
9. Determine if the contractor's management system requires strict adherence to budgetary controls and if managers' bonuses or incentives are determined based on performance against some predetermined budget. Tight budgetary policies may increase the risk	

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of labor mischarging.	
10. Determine if labor is being charged to contracts with available funding rather than to the actual contracts being worked on. This requires the auditor to be alert to this type of situation and to consider factors other than cost in determining the existence or extent of this practice. The contractor may be diverting costs that are over the contract funds or budget to other cost objectives. For example, a contractor may have already reached the contract fund limit before deliveries are to be made and may now be diverting contract costs to other contracts or cost objectives. An analysis of recent deliveries made under this contract may reveal that no labor costs were charged to the contract during the period when deliveries occurred.	
11. Evaluate the contractor’s labor charging practices for restructuring activities.	
a. Determine if the contractor is properly classifying restructuring activities in accordance with established agreements and DFARS 231.205-70, if applicable.	
b. As actual restructuring expenditures near the negotiated restructuring cost ceiling, there is a risk that restructuring costs may be mischarged to other accounts. Determine if the incurred and projected restructuring costs are near or in excess of the negotiated ceiling.	
12. Identify significant contract provisions. (CAM 6-200)	
a. Evaluate contracts and contract modifications for certain provisions which increase the incentive for labor mischarging. An example of such a provision is one that places ceilings on certain cost elements.	
b. Evaluate T&M and technical services type contracts to determine if they include task order funding ceilings. These ceilings prohibit the contractor from recovering any costs incurred above the ceiling limit.	
c. Determine if any contracts contain "Cost Sharing" clauses which require the contractor to provide goods or services at no cost or reduced costs to the Government.	
13. Identify Contract Definition (CD) Contracts.	
a. Read CAM 6-404.6b(8) for the definition of CD contracts.	
b. Identify all CD contracts. These contracts are high-risk contracts and, therefore, should be evaluated to make sure all allocable effort is being charged.	
14. Determine if the contractor has related or similar cost-type and fixed-price contracts for the same or similar items. This situation affords	

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the opportunity to mischarge labor between the related or similar contracts.	
15. Determine if the contractor has significant amounts of labor being incurred at offsite locations and determine if an assist audit is required based on the level of risk at the offsite location (risk assessment factors to consider are included in CAM 6-405.3(a)). Floor checks or labor interviews should be performed at every significant off-site location at least once every three years. If an assist audit request is determined necessary, request assist audits in accordance with CAM 6-805.1. (MAAR 12)	
16. Determine if the contractor has an employee work at home (WAH) program and assess the materiality of the costs incurred by employees in the program. (CAM 6-405.5)	
17. Determine if the contractor is charging certain categories of labor directly to Government contracts contrary to the manner in which the costs were reflected in the bid proposal or contrary to the treatment accorded commercial contracts. The treatment of pre-contract and post-contract costs should be evaluated.	
18. Evaluate any other significant conditions which may influence contractor labor charging practices. This will require knowledge of the particular contractor location and should be discussed with the supervisory auditor to develop the appropriate audit procedures.	

D-1	Determining Additional Effort	W/P Reference
Version 4.4, dated November 2009		
1.	Read CAM 6-404.7.	
2.	Analyze the information gathered in Preliminary Audit Effort (Section B-1) and the Conditions Influencing Labor Charging Practices (Section C-1). Evaluate the information in aggregate as it relates to all other information known about the contractor.	
3.	Use the results of the analysis to identify potential area(s) where the risk of labor mischarging is high and the Government's vulnerability is significant enough to warrant further evaluation (see CAM 6-404.7b(1) and (2) for examples of conditions indicating high risk area(s)).	
4.	Discuss the results of the analysis with the audit supervisor and adjust the scope of the audit accordingly.	
5.	If high risk areas warranting further evaluation are identified, perform the steps in the Pre-Interview Analysis (Section E-1).	

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<p>6. If no high risk areas are identified, discuss with the audit supervisor either terminating the evaluation or performing a floor check as described in the Floor Check Procedures (Section G-1).</p>	
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E-1	Pre-Interview Analysis	W/P Reference
Version 4.4, dated November 2009		
1.	Read CAM 6-404.8.	
2.	For each high risk area identified, determine the population of related employees.	
a.	Evaluate recent labor distribution documents and payroll runs to identify all employees charging labor effort or assigned to the risk area. (Consider using data retrieval software programs.)	
b.	Prepare a schedule of employees charging a major portion of their time to the risk area.	
c.	Evaluate other relevant available documentation related to the risk area, e.g., organization charts, travel reports, contract files, work authorizations, material inspection and receiving reports, contract status reports, etc. This evaluation may identify employees who have worked on the contract but have not charged labor effort to it.	
d.	For employees identified in 2.a and c above, schedule labor time charges for an appropriate recent period of time.	
e.	Determine if any significant trends, irregularities, or inconsistencies in charging patterns exist. Make note of these employees.	
f.	For employees identified in 2.e, inspect timecards, electronic labor input reports, or other labor entry source documents starting with the most current time period. Analyze each labor input media (e.g. timecard) for consistent time splitting, changes in charging patterns, corrections, alterations, whiteouts, or indications that someone other than the employee is completing the timecard or electronically inputting the employee's time.	
g.	For employees identified in 2.f above, evaluate travel reports and compare travel expense reports to labor distribution charges. Note any irregularities or inconsistencies.	
h.	For employees performing on T&M contracts identified in W/P C-1, Step 3, compare employee qualifications from personnel records to those required by the contract.	
i.	Understand the nature of the work of each contract/cost objective	

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charged by these employees during the test period, the time spent on each job, and other relevant information.	
3. Select employees for interviews based on the results of the evaluation performed in 2 above. Select those employees whose time charges and other documentation indicate a high probability of mischarging.	
4. If no employees in the high risk area appear to have questionable time charges, discuss terminating the audit of the risk area with the audit supervisor.	
5. For those employees selected for interviews, prepare working papers to document the interview. Working papers should include the employee name and ID number, date of the interview, the attendees, the reason for employee selection, interview summary, audit conclusion, and any follow-up audit work necessary.	
6. Formulate the questions to be asked during each interview. The questions should be factual in nature, tailored to each employee interviewed, and designed to confirm or dismiss the suspected mischarge. Avoid questions which solicit the employee's opinion. Each employee to be interviewed requires the formulation of specific tailored questions. However, general information should be solicited from each employee, such as;	
a. employee name and ID number	
b. current job title, position description	
c. current projects and period of performance	
d. description of work performed during the period under evaluation	
e. percentage of time spent on each project	
f. charge numbers/accounts used to record time spent on each project	
g. employee's timekeeping procedures, including any informal records used to record time and identify projects	
h. if applicable, the employee's supervisory responsibilities and related procedures including assigning and reviewing the work of subordinates; reviewing, changing, and approving time charges; controlling project costs/budgets; approving overtime; etc.	
7. Discuss the questions to be asked each employee with the audit supervisor.	

F-1	Conducting Detailed Employee Interviews	W/P Reference
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1. Read CAM 6-404.9.	
2. Brief the other member(s) of the audit interview team on the purpose of each interview and the questions to be asked.	
3. Conduct the interview at the employee's work location.	
4. Ask the general and specific questions formulated for each employee to confirm or dismiss any suspected labor mischarging and to establish compliance with timekeeping controls.	
5. Record the employee's complete responses and note any inconsistent comments or reactions. Ask appropriate follow-up questions to help clarify responses.	
6. Obtain any available documentation to substantiate the employee's labor efforts on each project.	
7. If the interview provides indications that other persons within the department or work area may be involved in mischarging their time in a manner similar to the employee currently being interviewed, conduct additional interviews before leaving the department/work area.	
8. If appropriate, question management, accounting, or other personnel to further clarify or confirm the employee's statements.	
9. Complete employee interview working papers immediately after completing the interviews.	

G-1	Floor Check Procedures	W/P Reference
Version 4.4, dated November 2009		
Note: Observations of work areas (floor checks) are appropriate when there is limited Government risk or vulnerability. In addition, performing floor checks will help satisfy the mandatory annual audit requirement relating to labor floor checks (MAAR 6). If conditions indicating a high probability of mischarging exists, employee interviews should be performed.		
1.	Read CAM 6-405.	
2.	Obtain a control list or roster of employees assigned to the department or area to be checked.	
3.	Depending on audit circumstances and objectives, randomly or judgmentally select employees to be floor checked. If a random selection is planned, use the procedures described in Appendix B of CAM.	
4.	Gather appropriate background data on the selected employees such as	

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<p>ID number, job classification, and nature of work usually performed by the employee and his/her department or cost center prior to conducting the floor check.</p>	
<p>5. Prepare worksheets to use during the floor checks to help guide the questioning and facilitate the recording of the employee's responses. (See LBR – Floor Check Worksheet in “Other Audit Guidance.”)</p>	
<p>6. If not already done, request the contractor to designate a representative to accompany each audit team during the floor check.</p>	
<p>7. Request representatives of the contracting officer to accompany the audit team(s) during the floor check.</p>	
<p>8. Brief all audit team members on the overall audit objectives and necessary background information.</p>	
<p>9. Obtain a plant layout and note the selected employees' locations.</p>	
<p>10. Floor check the employees selected.</p>	
<p>a. Identify each selected employee by verifying the employee's ID number and name to the control list or roster.</p>	
<p>b. Discuss the nature of the work being performed and observe the actual work performance to determine whether the employee is performing in the proper direct or indirect labor capacity and whether the time is being charged correctly. If the work is technical in nature, see Section B-1, Preliminary Step 4.</p>	
<p>c. Discuss the employee's timekeeping procedures to determine compliance with internal controls.</p>	
<p>d. Compare employee responses with previous data gathered. If inconsistent, ask appropriate follow-up questions.</p>	
<p>11. For selected employees not available for the interview, attempt to perform a follow-up interview. If a follow-up interview is not practical, perform additional audit steps to verify employee existence. These steps may include: an observation of the employee’s work area, an evaluation of the employee’s personnel/security files, and/or a follow-up telephone interview.</p>	
<p>12. When an employee selected to be floor checked is not present at the normal work-site due to a work at home (WAH) program, the employee’s supervisor should be interviewed. Discussions with the supervisor should concentrate on obtaining evidence of the employee’s work and documented evidence of supervisory control over the employee’s WAH schedule. The auditor should also communicate with the employee by telephone to determine if the employee has knowledge of WAH procedures, and discuss the specific type of work being performed along with the related labor charge numbers. If the employee has a regularly scheduled meeting</p>	

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with the supervisor in the near future, any questionable procedures or practices identified by these steps can be discussed and verified with the supervisor and employee at that time. In addition, the individual’s employment should be verified to the payroll/personnel records. See CAM 6-405.5.	
13. Obtain prompt explanations concerning all questionable procedures observed. This may require discussions with employee supervisors, contractor management, accounting, and other appropriate personnel.	
14. Reconcile the observations regarding the employees' labor charges with subsequent payroll and/or labor distribution records and follow-up on any discrepancies. For assist audits conducted at off-site locations, the auditors at the primary location are responsible for reconciling the time charges collected at the time of the employees’ floor checks to the labor distribution records when the official books and records are maintained at the primary location.	

H-1	Development Of Findings	W/P Reference
Version 4.4, dated November 2009		
1.	Read CAM 6-404.10.	
2.	Analyze data gathered during the interviews or floor checks with all information previously gathered to either confirm the employee labor mischarge or establish the propriety of the labor charges.	
3.	Discuss audit results and all confirmed labor mischarges with the audit supervisor.	
4.	Determine if the labor mischarges represent isolated instances or indicate more widespread conditions. This may require the performance of additional employee interviews or floor checks.	
5.	Determine if more audit effort is needed to fully support the audit conclusions.	
6.	Determine any costs questioned related to labor mischarges. Costs questioned should be specifically identified to each risk area.	
7.	If conditions which may indicate fraudulent or other suspected irregular activities are disclosed, promptly report these as described in CAM 4-702.4.	
8.	Incorporate any assist audits (CAM 6-805), and follow-up on any outstanding assist audits.	

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A-1	Concluding Steps	W/P Reference
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1. Read CAM 6-403.		
2. Conduct an exit conference in accordance with CAM 4-304.		
3. Discuss the audit findings and recommendations with the contracting officer.		
4. If no significant deficiencies are disclosed, prepare a MEMORANDUM FOR RECORD to close the assignment and incorporate the results into the final incurred cost audit report. If significant internal control deficiencies are disclosed, draft a flash audit report using the format in CAM 10-413. Use the format in CAM 10-808 for reporting CAS/FAR noncompliances.		
5. If applicable, schedule a follow-up evaluation to be performed within a reasonable period of time.		
6. Summarize and cross-reference working papers. Submit the audit working paper package for supervisory review.		
7. Update the ICAPS or ICQ, as appropriate. (MAAR 1)		
8. Update the Permanent File for Labor, as appropriate. (MAAR 3)		
9. Update the MAARs Control Log (see M-MAARS or M-MAARS-CIC, Activity Code 10100, Other Audit Guidance) as appropriate. Prepare a MAARs control log for the contractor’s fiscal year if one has not already been prepared.		