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Accounting and Auditing under Cost-Plus-a-Fixed-Fee Contracts

BY LINCOLN G. KELLY

PROBABLY the most effective way of impressing upon the general public, the citizens who are required to pay the bills, and the accounting profession, the importance of adequate accounting and auditing is to call attention first to the vast sums of money involved in the preparedness program. When we take into consideration the huge sums appropriated by the present Congress for this purpose, we find it almost impossible to visualize the volume of transactions which must be accounted for if the expenditures are to be safeguarded by complete and satisfactory accounting and auditing. We are dealing with a great volume of more or less complex transactions, running into a total of many billions of dollars and far exceeding anything that has ever been undertaken in this country, and probably in any other country, for a like purpose, and under circumstances which make the accomplishment of the program imperative within an exceedingly short period of time. Fundamental requirements of the program call for the united coöperation of industry, of labor, and of the government, and the success of the program depends upon the continuous maintenance of this united coöperative effort. It is of most vital concern to every citizen of the country. It concerns every certified public accountant and all of the clients of certified public accountants. It is most fitting that the place of the

accounting profession and individual members of the profession in the defense program should be discussed at this annual meeting.

The situation certainly presents an opportunity for the profession and for individual certified public accountants to make a worth-while contribution to the most vital interests of the United States Government—that of properly protecting and safeguarding the vast expenditures of public money appropriated by Congress for the preparedness program—to afford protection not only against irregularities but against the possibility of mistakes, of misunderstandings, and of incompetency and carelessness, and at the same time avoid the interruption of the necessary speed in carrying out the program. Professional accountants have not, as a rule, been given an opportunity to contribute to the full extent of their capabilities in governmental activities. While their services should be sought and availed of to the fullest extent in national affairs, and particularly in a national emergency, the real need for their services has not in all cases been apparent to government authorities, and their capabilities and functions are not yet sufficiently recognized. During the past few years committees of the Institute, coöperating with the National Committee on Municipal Accounting, have rendered signal service in bringing about broader recognition of the services of certified public accountants to municipal and to all governmental agencies. Members of the profession

NOTE.—Address presented October 17, 1940, at the annual meeting of the American Institute of Accountants, held at Memphis, Tenn.

should embrace every opportunity to demonstrate that they have a really important place in the conduct of affairs of government. Particularly in the national defense program are their services of prime importance in safeguarding the interests of the United States Government. Their training, experience, and independent judgment fit them for a professional service which is most urgently needed.

In passing upon the regularity and propriety of the huge expenditures involved in the vast construction and expansion program, which must be conducted under extreme pressure and with the utmost speed, "speed with safety" should be the watchword. It seems that it may still be necessary to carry on a campaign of education thoroughly to convince the public of the real value of the services of professional accountants in providing adequate accountability for expenditures involved in all extraordinary undertakings by the federal government. It is the duty of the profession to convince the public with respect to the general qualifications and capabilities of its members. As soon as the public is convinced, a demand will be made that the services of certified public accountants be availed of wherever the interests of the taxpayers require it.

It is entirely wrong to wait until the vast sums have all been expended before calling in the aid of professional accountants. They can then only report on what has become history and point out the mistakes and irregularities that have occurred. They can be more valuable if their advice and counsel are sought at the beginning, when they are called upon to take an important part in the planning and organization of the spending agencies, and when given an opportunity to provide adequate controls and safeguards, before the actual spending takes place. I believe it can be said without contradiction that wherever the services of certified public accountants

have been used extensively in some particular phase of governmental affairs the results have been highly satisfactory and have reflected credit on the profession as a whole, and such agencies, departments or divisions of the government have recognized the value of the services and the professional status of the accountant.

The American Institute of Accountants was, in fact, recognized by the construction division of the Army during the World War, and it was through the facilities of the Institute that the accounting division of the construction division of the Army during that period was organized. At the beginning of the then construction program, which was being carried out under the cost-plus form of contract, twelve members of the American Institute of Accountants were appointed as divisional auditors, and under their supervision a pre-audit was made of the expenditures involved in construction costs before making reimbursement to contractors. The following members of the Institute acted as divisional auditors during that period:

David E. Boyce
Robert Douglas
W. P. Hilton
J. Porter Joplin
Page Lawrence
A. G. Moss
Walter Mucklow
W. P. Musaus
Colonel Charles Neville
Herbert M. Temple
Charles E. Wermuth
Wm. Whitfield

As a result of the splendid work done by these men, the field auditors, and the technical staffs who served under their supervision and direction, the construction division received the highest of commendation for the prompt and efficient manner in which the audits were kept absolutely current with the work as it progressed, so that there was no delay in the payments to contractors.

Considering that speed was the essence of the program at that time, irregularities were few and relatively insignificant. As a result of its experience during the last war, the construction division again recognizes the importance of sound accounting and auditing in the present emergency program. This division is again entrusted with the very great responsibility of expending the vast sums appropriated by Congress for the construction of plants, facilities, etc., in the national preparedness program, within the shortest possible time. The national situation is recognized as demanding every effort to expedite this work, but it is also borne in mind that the fullest possible protection must be provided against irregularities and mistakes in expenditures. In the present organization of the accounting and auditing branch, construction division, Quartermaster Corps of the Army, we have pointed out that two general principles must be observed in the safeguarding of the disbursement of public funds. These are: (1) the adequate accounting and determination of the amounts to be paid; (2) the verification or audit of the accounting. These fundamental principles were fully observed during the war emergency of 1916-1918 in driving through that construction program. They are elemental and controlling in the consideration of procedure for the accounting and auditing requirements under government contracts based on cost-plus-a-fixed-fee.

It will be readily apparent that the responsibilities for the auditing are far greater where the cost must be controlled and the auditor must certify to the legality and regularity of the items before payment. The accounting and auditing branch of the construction division is being organized with these basic considerations in mind, which require that the accounting and auditing be maintained by proper division of these two distinct functions, with

separate personnel, and that tremendous responsibilities rest on individual governmental representatives entrusted with these enormous expenditures. Of primary importance, therefore, is the selection of the best qualified auditing personnel that may be available. The construction division is thus proceeding on the theory that only by current detailed pre-audit of the expenditures can the government's interest in the prosecution of the work under the many contracts be safeguarded.

The policy adopted is to entrust authority to and put responsibility upon the government representatives in the field, so far as this is practicable. The constructing quartermaster at each project is vested with executive authority as the government's representative. All communications between the Washington office and the field auditor at the project are now required to be channeled through the constructing quartermaster.

Governed by the decentralization policy, the organizing of the accounting and auditing branch proceeds along lines which will provide for project auditing, in the protection of the government's interests, as an independent examination, the field auditor appointed to each project being personally responsible for the correct and efficient accounting and auditing. While the position of the field auditor in the lines of organization is that of assistant to the quartermaster, the technical responsibility for the auditing rests directly upon him. As in the case of a professional audit, the verification is not made *by* the constructing quartermaster, but *for* him. In a sense it is an audit of his accountability. The intent and purpose is to assure the constructing quartermaster (in the line of government administration) that every expenditure is in conformity with authorization, and that the record duly attests to verification of its propriety.

The accounting and auditing branch

is charged with the responsibility for the engagement of qualified and efficient field auditors and for the maintaining of such advisory and supervisory relations with them as will afford assurance of the satisfactory pre-auditing of the disbursements for each project. Obviously, the field auditor must be a well trained accountant of wide experience, with high executive ability. This is particularly true in the case of the larger and more complex projects. The knowledge, experience, and judgment demanded are such as possessed by certified public accountants conducting their own practice, individually, or as senior partners.

The functions of the accounting and auditing branch include:

1. Furnishing the field auditors with full instructions (in so far as this is practicable) respecting the approved set-up of their organization and the established procedure and practice adapted to the requirements of government accounting. The principles underlying the requirements of an audit will be familiar to the individual field auditor and will, of course, be fully observed by him.
2. Engaging qualified personnel for principal assistants to the field auditor (to the extent necessary) and arranging for the prompt availability thereof in advance of the beginning date of operations.
3. Making advance arrangement for employment of material checkers, inspectors, timekeepers, etc., to be available as required. So far as practicable, these employees will be engaged locally by the field auditor, the facilities of the Washington office to be availed of for obtaining competent personnel in case such employees are not obtainable locally.
4. Extending to the field auditors the promptest possible assistance in respect to any problems that may be encountered.
5. Keeping in touch, through traveling representatives, with the conditions at the different projects pertaining to accounting and financial matters.
6. Obtaining reports from the field auditors for the purpose of maintaining at the Washington office such records as are necessary to afford adequate knowledge of the efficiency of the project accounting, and for the purpose of furnishing the necessary information respecting the status of the operation, and so forth.
7. Consulting with office of the Comptroller General respecting government requirements in relation to the accounting.

I am not familiar with the procedure being followed in accounting for and auditing the vast expenditures being made by other divisions and agencies of the federal government, but it is certain that expenditures under the cost-plus-a-fixed-fee or similar type of contract cannot be adequately safeguarded by post-audits ordinarily made two or three years after the transactions have occurred. In fact, no post-audit can be adequate to safeguard governmental expenditures under this type of contract. The verification must, of necessity, reach to the very source to warrant a certification by the field auditor or other responsible government representative with respect to the correctness and regularity of the expenditures. This involves the actual checking of the time of all employees of the contractor engaged at the project currently as the payroll accrues, as well as the verification of the rates of pay and the actual witnessing of the payment in each case by a government representative. It also involves the maintaining of adequate control of all expenditures for material and equipment from the issuance of a purchase order to the final preparation of the voucher through which the contractor is reimbursed, including the verification of the actual receipt of all material and equipment through the use of material and inspection reports verified by reports of the field auditor's staff. It seems imperative to me that all agencies of the government operating

under the cost-plus-a-fixed-fee type of contract must finally recognize the fundamental importance of a detailed pre-audit in order actually to safeguard these vast expenditures in a manner that must have been intended by Congress in authorizing enormous expenditures for national defense.