



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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IN REPLY REFER TO

PSP 730.5.1.A/2010-020

June 4, 2010  
10-PSP-018(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA  
DIRECTOR, FIELD DETACHMENT, DCAA  
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Alert on Reporting on Forward Pricing Rates in Pricing Proposals

**SUMMARY**

This audit alert clarifies policy on the reporting on forward pricing rates included in pricing proposals when the audit of rates has not been completed at the time of report issuance. In summary, since direct and/or indirect rates usually represent such a significant portion of a pricing proposal, auditors should disclaim an opinion on the proposal taken as a whole if the audit of those rates has not been completed. Therefore, to comply with Generally Accepted Government Auditing Standards (GAGAS), audit reports on pricing proposals generally should not opine on the forward pricing rates unless the cognizant FAO has completed its audit of the rates that have a material impact on the proposal. Instead, the approach discussed in CAM 9-209 should be followed. That guidance states, "the audit report will clearly describe, as part of the purpose [i.e., subject] and scope section, what parts of the proposal were examined." In addition, the guidance states, "the opinion and report exhibits will address only the parts of the proposal examined. An opinion will be disclaimed for the proposal taken as a whole." If requested to audit the complete proposal, the audit report should also state that a supplemental report will be issued once the audit of the direct and/or indirect rates is completed.

**BACKGROUND**

The Quality Assurance team has found instances where DCAA opined on the complete proposal when the audit of the direct and/or indirect rates was not completed at the time of report issuance, even though the unaudited rates represented a material portion of the proposal and the potential effects on the proposal due to the omitted procedures was pervasive. The Results of Audit section of the audit report (including the audit opinion and supporting exhibit and schedules) contained amounts associated with cost elements (e.g., direct and or indirect rates and factors) that represented a material portion of the price proposal that were either only partially examined (e.g., only analytical procedures performed) or not examined at all. Reviews have also identified cases where the audit opinion included the application of rates from a forward pricing rates agreement (FPRA) where DCAA had not audited the proposed rates upon which the FPRA

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was based. Since direct and/or indirect rates usually represent a material portion of a pricing proposal, issuing even a qualified audit opinion on the complete proposal without completing an audit of the indirect rates generally is not compliant with GAGAS.

## **GUIDANCE**

Costs associated with direct and/or indirect rates are generally so significant to a pricing proposal that the auditor should disclaim an opinion on the proposal taken as a whole if the audit of those rates has not been completed. Audit reports on pricing proposals should not opine on forward pricing rates that are significant to the proposal unless the cognizant FAO has completed its audit of the rates. An examination of forward pricing rates includes detailed testing of the contractor's assertion (i.e., proposal and basis of estimates) and, when appropriate, analytical procedures (e.g., regression or trend analysis). When forward pricing rates that are significant to the proposal have not been examined or were only partially examined, the pricing proposal audit reports should clearly describe, in the subject and scope sections, what parts of the proposal were examined. The subject and scope should specifically note that the audit of the rates has not been completed and therefore, they are not covered in this report. The results of audit section (including the opinion and exhibits) will not address or contain amounts associated with those rates. In addition, the report will disclaim an opinion on the proposal taken as a whole. Following that disclaimer, the report should note that DCAA has not completed the audit of the rates and that the costs associated with the unaudited rates are significant to the proposal. Therefore, we recommend that contract price negotiations not be concluded until the audit of the rates is completed and the results are considered by the contracting officer. The audit report should also state that a supplemental report will be issued once the audit of the direct and/or indirect rates is completed.

When proposed rates are based on rates from a FPRA or a Forward Pricing Rate Recommendation (FPRR) and DCAA has not audited the rates, the rates should be audited as part of the current pricing proposal audit, if possible. In those instances where it is impractical to audit the rates as part of the current pricing proposal audit and the pricing proposal audit report is issued prior to the completion of the separate audit of indirect rates, follow the guidance in the paragraph above regarding the report content (modified to state that the proposed rates were based on the current FPRA or FPRR and that DCAA has not audited those rates).

In cases where DCAA has performed an audit of forward pricing rates and DCAA's audit was utilized by the ACO in negotiating the FPRA, the FAO may opine on these rates in the pricing proposal audit report. This is true even if there are differences attributable to the negotiation process between the rates per DCAA's audit and the FPRA rates. However, if the FAO believes the ACO did not fully consider the DCAA audit results and there are significant differences between the DCAA recommended rates and the FPRA or FPRR, the FAO should elevate this disagreement in accordance with Agency policy as detailed in our memorandum MRD 10-PAS 015(R) dated, May 27, 2010. If the pricing proposal audit report must be issued prior to resolving this disagreement, the audit opinion should reflect the DCAA recommended rates.

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If requested, FAOs may provide available unaudited rate data to contracting officers to assist them in their negotiations generally following the procedures in CAM 9-107. This information should be furnished in a separate memorandum and it should clearly state that the rate data provided has not been audited. In addition the memorandum should include the following statement:

The scope of the work performed does not constitute an audit or attestation engagement under GAGAS.

To illustrate current Agency policy, we have included in the Enclosure examples of situations that may be encountered with the audit of indirect rates as part of a pricing proposal.

### **CLOSING REMARKS**

FAO personnel should direct questions regarding this memorandum to their regional offices, and regional personnel should direct any questions to Pricing and Special Projects Division, at (703) 767-3290 or e-mail at [DCAA-PSP@dcaa.mil](mailto:DCAA-PSP@dcaa.mil).

/Signed/  
Kenneth J. Saccoccia  
Assistant Director  
Policy and Plans

Enclosure:  
a/s

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## **Example Scenarios Reporting on Pricing Proposals When Audits of Indirect Rates are not Completed**

### **Example 1: Unaudited Forward Pricing Rate Proposal (FPRP) or Other Unaudited Rates:**

The proposal you are auditing contains direct and/or indirect rates based on an FPRA. DCAA did not audit the FPRP that was the basis for the FPRA. You have commenced an audit of these rates, but it will not be completed until after the report on the subject proposal audit is issued. Since we have not audited the rates, you should only opine on the direct costs and hours (use language from the audit of parts of a proposal report shell modified for the circumstances) and you SHOULD NOT address or include amounts associated with those rates (i.e., quantify the impact of rates) in the audit report. In addition, it is not appropriate to provide rate recommendations in a proposal audit based on your audit of a *prior* FPRP that was not used by the contractor in the subject proposal. Remember, you are opining on the proposal as submitted; if the proposal contains rates you have not audited, you cannot opine on them.

If the buying command wants to see the impact of the unaudited FPRR/FPRA rates on the reported audit results, you can do so via a memorandum under a 25000 (Specific Data Request) activity code. However, the memorandum should clearly state that the rates are unaudited and the schedule (or other information) is provided for informational purposes only. The memorandum should state "The scope of the work performed does not constitute an audit or attestation engagement under generally accepted government auditing standards."

### **Example 2: Audited FPRA Rates – No Significant Differences from DCAA Recommended**

You performed an audit of the FPRP that resulted in the ACO negotiating an FPRA. There are no significant unresolved differences between your audit recommended rates and the FPRA rates; therefore, you may include the FPRA rates in your pricing proposal audit and opine on them, provided you have performed and documented sufficient analysis/procedures in the proposal audit to ensure that the subject proposal is included in the contractor's business base, or would not materially impact the FPRA rates, if it is not.

### **Example 3: Audited FPRA Rates – Significant Differences from DCAA Recommended**

You performed an audit of the FPRP that resulted in the ACO negotiating an FPRA, however there are significant differences between DCAA recommended rates and the FPRA. The significant differences in rates should be elevated, following Agency guidance, as soon as the auditor becomes aware of this situation. If the differences are not substantively resolved before the report must be issued, the auditor will incorporate DCAA recommended rates into the audit report opinion and results of audit. However, testing must be performed in the proposal audit to ensure that the subject proposal is included in the base, or would not materially impact the rates, if it is not.

### **Example 4: Audited or FPRA Rates for Only Partial Period of Performance**

You have audited rates and/or an FPRA based on our audit for CY 2010 - 2011. The pricing proposal goes out to CY 2013 but we have not audited rates for CY 2012 and 2013. If there is budgetary data to support the rates for CY 2012 and 2013, you should review that data as part of the pricing proposal audit and develop an audit position for those years. If there is no budgetary data for the out-years, the proposed indirect costs associated with the out-years should be reported as unsupported with either a qualified or adverse opinion, depending on the significance of the indirect costs for those years.