



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

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

**SUBJECT:** Audit Guidance on Audit Procedures Related to Long Term Agreements (LTAs)

**SUMMARY**

In evaluating proposed subcontract costs, auditors may identify an estimate based on a Long Term Agreement (LTA). An LTA is an agreement entered into between a prime contractor and a subcontractor to establish pricing for future purchases of specified items. LTAs are an acceptable pricing method since FAR allows a prime contractor to reach price agreement with a subcontractor in advance of agreement with the Government. It is not uncommon for contractors to enter into an LTA with a subcontractor in advance of a specific Government Request for Proposal (RFP). An LTA can benefit the Government by providing better subcontract pricing due to a more stabilized business volume and reduced acquisition cycle times. Auditors should evaluate the prime contractor's analysis of cost or pricing data at the time the LTA was established while also considering the procedures performed by the prime contractor to demonstrate that the LTA price continues to be fair and reasonable. It should be noted that the existence of an LTA negotiated prior to a prime contract award does not relieve the prime contractor from obtaining certified cost or pricing data prior to subcontract award when required by FAR 15.404-3(c). If the auditor determines that assist audit services are necessary, subcontract auditors should generally evaluate the LTA pricing at the time that it was executed while also considering any known factors that may impact the reasonableness of the LTA's current price. Specific questions auditors have had concerning LTA pricing are addressed in the enclosed Frequently Asked Questions.

**GUIDANCE**

LTAs are an acceptable pricing method since FAR allows a prime contractor to reach price agreement with a subcontractor in advance of agreement with the Government. FAR 15.404-3(c) provides that the contractor obtain and analyze certified cost or pricing data before awarding any subcontract expected to exceed the cost or pricing data threshold (i.e., \$700,000 as of October 1, 2010), unless an exception in FAR 15.403-1(b) applies (e.g., adequate price competition, commercial item, etc.). This requirement applies to all subcontract awards regardless of how far in advance a price agreement is reached (see FAR 15.404-3(c)(4)).

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Based on these provisions, we also interpret that contractors are generally not required to obtain updated cost or pricing data when proposed subcontract costs are based on existing LTAs that were negotiated in accordance with applicable FAR and DFARS requirements.

If the subcontract value under the LTA is expected to exceed the cost or pricing threshold and none of the exceptions in FAR 15.403-1(b) apply, the contractor must obtain and analyze certified cost or pricing data as of the date of LTA execution. The auditor should evaluate the reasonableness of the proposed subcontract cost by verifying that:

- 1) The contractor has established practices for obtaining and analyzing cost or pricing data from subcontractors, (CAM 9-406.1), and
- 2) The subcontractor submitted adequate cost or pricing data in support of the LTA (FAR 15.403-4(a)(1)(ii)), and
- 3) The contractor completed an adequate cost or pricing analysis (CPA) of the subcontractor cost or pricing data (FAR 15.404-3(c)), and
- 4) The contractor has demonstrated the continuing reasonableness of the LTA price as included in the current prime contractor proposal.

Auditors will determine if assist audit services are needed considering the factors in CAM 9-104.2b (e.g., significance of proposed subcontract costs, business relationship of prime and subcontractor, etc.). If requested, the subcontract auditor will generally review the subcontractor's cost or pricing data as of the date of the LTA execution. However, the subcontract auditor must also consider any known factors that may impact the reasonableness of the LTA's price relative to the current proposal. For example, the subcontractor may have made significant changes in the manufacturing process that were not considered in the original LTA pricing.

If an exception to certified cost or pricing data applies (i.e., adequate price competition, commercial item, see FAR 15.403-1(b)) yet the LTA prices are based on cost data; the auditor should evaluate the contractor's analysis following the general guidelines as discussed above. However, if the LTA was awarded requiring no cost based data, the auditor should review the contractor's price analysis to ensure that the LTA pricing is fair and reasonable. For example, on competitive acquisitions auditors should evaluate the degree of competition and the contractor's rationale for making the source selection (CAM 9-104.1). In addition, the contractor has the responsibility for demonstrating the continuing reasonableness of the LTA price as included in the prime contractor proposal.

When any of the contractor's required analyses are found to be incomplete or inadequate, the procuring contracting officer should be immediately notified, and the proposed subcontract cost should be reported as unsupported (CAM 9-104.2d). Generally, the risk that an LTA price is no longer reasonable increases as conditions change, which is more likely to occur with time. Auditors should consider expanded testing of the contractor's analysis and/or assist audit, in cases where the LTA is substantially aged. DFARS 215.407-5-70(d)(3)(ii), Estimating Systems, states that the contractor's continuing failure to perform subcontractor cost or price analysis, as required, is a significant estimating deficiency.

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Therefore, an estimating system flash report should be issued if the contractor fails to perform LTA cost or price analysis, as required.

**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/  
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DISTRIBUTION: C

a/s

## **FREQUENTLY ASKED QUESTIONS SUBCONTRACT COSTS SUPPORTED BASED ON LTAs**

**Question 1:** Is there a specific time period (e.g., 18 months) for which LTA pricing should be considered adequate and no action by the prime contractor would be needed?

**Answer:** No. The market and other conditions must be reviewed on a case by case basis. In some cases the LTA pricing may be adequate for several years, yet in other cases a single month may find that the LTA pricing is no longer fair and reasonable. For example, the subcontractor may have made significant changes in the manufacturing process that were not considered in the original LTA pricing.

**Question 2:** Is the escalation of a previously negotiated LTA pricing adequate?

**Answer:** No. An LTA represents a firm price agreement between the prime and the subcontractor; therefore, simply escalating a previous LTA pricing would not be appropriate. When LTA pricing has expired the prime contractor is entering into a new pricing action and should require the subcontractor to submit updated cost or pricing data if none of the exceptions in FAR 15.403-1(b) apply. Even when cost or pricing data is not required, escalation of a previous price is generally not adequate to support that the new pricing is fair and reasonable.

**Question 3:** Is the prime contractor required to provide the subcontractor's cost or pricing data supporting the LTA for all future government proposals?

**Answer:** Yes. When required by FAR 15.404-3(c) the prime contractor is required to submit subcontractor cost or pricing data to the Government as part of its own cost or pricing data and support the continuing reasonableness of placing orders under the LTA.

**Question 4:** Can an audit be performed of the LTA pricing prior to the issuance of a Government RFP?

**Answer:** No. As there is no current Government requirement related to the LTA pricing it would generally be inappropriate to apply audit resources in support of the LTA.

**Question 5:** How should the LTA dollar value be determined for the application of cost or pricing data threshold in FAR 15.403-4(a)?

**Answer:** FAR 1.108 provides that, unless otherwise specified, a specific dollar threshold for the purpose of applicability is the final anticipated dollar value of the action, including the dollar value of all options. If the action establishes a maximum quantity of supplies or services to be acquired or establishes a ceiling price or establishes the final price to be based on future events, the final anticipated dollar value must be the highest final priced alternative to the prime contractor, including the dollar value of all options.

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**Question 6:** Can the subcontract auditor review an LTA proposal whose price is included in a prime contractor's proposal prior to the prime and subcontractor entering into the LTA pricing agreement?

**Answer:** Yes. Normally, DCAA assist audit procedures would be appropriate under these circumstances.