DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 730.5.35.1

September 6, 2012
12-PPD-023(R)

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

SUBJECT: Audit Guidance on Revised Policy and Procedures for Sampling Low-Risk Incurred Cost Proposals

SUMMARY

To ensure that our limited audit resources are applied to the areas and audits of highest risk, the policy for evaluating and reporting on low-risk annual incurred cost proposals is being revised (Enclosure 1). For the purposes of satisfying the audit requirements at FAR 4.804-5(a)(12), 42.705-1(b)(2), and 42.705-2(b)(2)(i), Defense Procurement and Acquisition Policy (DPAP) authorized a Class Deviation – DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals, dated July 24, 2012, (Enclosure 2). This deviation allows the Department of Defense contracting officers to continue to rely on either a DCAA audit report or a DCAA memorandum to satisfy the audit requirements in FAR. The revised policy and its implementation have been coordinated with Defense Contract Management Agency (DCMA).

POLICY

For in-process assignments where detailed audit steps have been started, auditors should complete the assignment as it was planned. For all other assignments, the auditor should follow the revised policy for sampling adequate low-risk incurred cost proposals described in Enclosure 1. In summary, all adequate incurred cost proposals under $250 million auditable dollar value (ADV) will be assessed for high or low risk using the Risk Assessment Checklist (Enclosure 3). All high-risk proposals will be audited and low-risk proposals will be sampled using the percentages identified in Enclosure 1. Under the revised policy, DCAA will no longer perform desk reviews. Those proposals not selected for audit will be dispositioned by a memorandum to the contracting officer (Enclosure 4). In addition, a mandatory audit of proposals will be performed every three years on proposals between $100 million and $250 million ADV.

The criteria for assessing the risk of a proposal includes prior incurred cost audit experience, any audit leads or other significant risk identified, as well as the significance of prior questioned costs. Auditors must use their professional judgment when determining that a specific proposal can be placed in the low-risk pool for sampling. Auditors must consider their knowledge of the contractor, the results of adequacy reviews, and other audit activity performed since completion of the last incurred cost audit (e.g., reported business system deficiencies, establishment of provisional billing rates, voucher processing procedures, real-time testing of direct costs, forward pricing audits, etc.) to determine if there are any risks that would warrant the contractor to be classified as high risk and an audit be performed, especially when significant time has elapsed since the performance of the last incurred cost audit.

Corporate, shared services and Intermediate Home Office (IHO) proposals will not be included in the low-risk sampling process. Corporate/IHO/shared services and segments should coordinate during the adequacy review and risk assessment process to determine if a corporate or home office audit is needed. Coordination efforts should be documented and maintained in the working papers at both Corporate/IHO and segments.

As with the previous desk review process, the revised incurred cost sampling policy does not apply to nonprofit organizations and educational institutions. The revised policy also will not apply to 100% non-DoD contractors at this time. Non-DoD agencies are interested in this process but are waiting to see the guidance before deciding whether to adopt the sampling process. We expect that it will be several months before the non-DoD agencies reach a decision on whether to rely on this sampling process.

Auditors are reminded that the primary objective of the initiative is to redirect audit effort to completion of high-risk and sampled incurred cost audits, beginning with the earlier year proposals first (i.e., oldest to newest). Therefore, to ensure the new policy does not adversely impact on-going audit effort, FAOs should coordinate with the contracting officer and time phase the issuance of the memorandums for proposals not selected for audit. To facilitate the implementation of the revised policy, we have included an implementation plan developed with the assistance of the Regions (Enclosure 5).

Once high-risk and sampled audits have been identified, FAOs should develop a plan to prioritize completion of the audits to support the Agency's goal of being current by the end of FY 2016.

Policy is in the process of updating CAM Chapters 6 and 10 to reflect the revised guidance. In addition, the low-risk sampling policy and procedures have been updated since issuance of the DPAP class deviation to remove the plan to not apply sampling to low-risk proposals $1M or less received prior to October 1, 2011 (Enclosure 1).

SAMPLING GUIDANCE

FAOs should perform risk determinations on all adequate final indirect rate proposals up to $250 million in ADV, focusing on the oldest proposals. DMIS Version 5.3 released in June 2012 allows FAOs to enter a risk code of high or low and a risk reason code for incurred cost proposals up to the $250 million threshold.

Operations will provide each region and Field Detachment (FD) with lists of incurred cost assignments (activity code 10100) where the FAOs have received adequate proposals and determined them to be low risk. The lists may include assignments with ADV of $15M or less coded as high risk with a reason of "mandatory third year audit," since the mandatory third year audit will now only apply to contractor proposals exceeding $100 million.

The lists will not include assignments identified as corporate or home office submissions (corporate audit status code = C). The lists will identify proposals coded as direct costs only (Inc Cost Contractor Type = D) to facilitate coordination between FD offices and the cognizant office. Assignments for direct costs should not be included in the sample universes.

The assignments on the lists provided to the regions will be coded in the sample universe field (i.e., LR4Q12) to indicate they have been included in a universe. The regions must review the lists and notify HQ-OWD of any assignments that should not be part of the universe. The assignment should be removed from the universe if, for example, the audit is already in process and detailed audit steps have been started; the submission is for a corporate or home office but not coded as such in DMIS; or all the contracts are non-DoD. HQ-OWD will clear the sample universe field for those assignments in DMIS. Although these assignments will be removed from the current universe, they will appear again in the next universe unless the in-process audit is completed, or the corporate audit status field is revised.

Regions should select a region-wide audit sample using EZ-Quant random number generator and apply the appropriate sampling rate for each universe strata described in Enclosure 1. The number of sample items should be rounded up. For example, if the universe consists of 169 incurred cost proposals with ADV of $1 to $15 million (5% sample rate), resulting in a sample of 8.45 items, the region should randomly select nine proposals for audit using EZ Quant to generate random numbers. The regions must return the lists to HQ-OWD annotating the "Sample Code" column with "X" for do not include in sample universe or "Y" for selected for audit. Using this data, Operations will either clear the sample universe field or enter the data identifying whether the proposal was selected for audit or not. Regions should document their sample selection process and file the documentation in Livelink under a folder named "720.9.2.7 – Incurred Cost Low-Risk Sample Selection" with subfolders for each sample.

Once the region completes the review of the sample universes and selects the samples, it should notify the FAOs to time phase (Enclosure 5) the closure of the low-risk proposals not selected using the procedures in Enclosure 1.

Operations is currently working on an application, similar to the Overdue Incurred Cost Submission Letter Tool, which can be used to generate draft memorandums. We anticipate that this application will be available by September 30, 2012.

CONCLUDING REMARKS

Headquarters hosted a teleconference with the Incurred Cost RAMs on August 14, 2012 to address implementation of this guidance. Headquarters is planning to have a teleconference with all of the impacted FAO managers prior to the end of September to address questions and assess progress on implementation. In addition, please see the Frequently Asked Questions for additional information (Enclosure 6).

FAOs with questions regarding this memorandum should contact their regional offices. Regional personnel should direct any questions regarding the sampling process to Workload Analysis Division at (703) 767-2257, or by e-mail at dcaa-owd@dcaa.mil. Regional personnel with any questions regarding the policy should contact Policy Programs Division at (703) 767-2270 or via e-mail at dcaa-ppd@dcaa.mil.

/Signed/
John C. Shire
Deputy Assistant Director
Policy and Plans

Enclosures: 6
1. Policy and Procedures for Low-Risk Sampling
2. DPAP Class Deviation
3. Risk Assessment Checklist
4. Memorandum to the ACO
5. Incurred Cost Sampling Implementation Plan
6. Frequently Asked Questions

DISTRIBUTION: E

DCAA Policy and Procedures for
Sampling Low-Risk Incurred Cost Proposals

POLICY

All incurred cost proposals should be evaluated upon receipt for adequacy, in accordance with FAR 52.216-7, using the DCAA Incurred Cost Proposal Adequacy checklist. If the incurred cost proposal is not adequate and the deficiencies cannot be remedied with minor effort, the proposal will be returned to the contractor with written instructions on required corrective actions, in accordance with CAM Chapter 6.

All adequate annual incurred cost proposals exceeding $250 million in auditable dollar value (ADV) will be audited. All other incurred cost proposals received and determined to be adequate will be assessed for risk. All adequate high-risk proposals will be audited.

CRITERIA FOR CLASSIFICATION OF PROPOSALS TO HIGH-RISK AND LOW-RISK POOLS

For all proposals with $250 million or less in ADV, FAOs should classify risk as high or low for all adequate incurred cost proposals on hand where an audit (field work) has not been started, using the criteria specified below:

Low Risk Proposal Criteria

- We have prior incurred cost audit experience (i.e., an incurred cost audit has been performed).
- No significant audit leads (including assist audits, corporate, intermediate home office or service center) or no other significant risk has been identified. For example:
  - any known business system deficiencies that would have a significant impact on the final indirect rate proposal for this FY;
  - significant risk identified by the contracting officer;
  - significant changes in the contractor organization or operations (e.g., significant increase in ADV); or
  - other significant risk identified by the audit team.
- No prior significant total exception dollar reported in the last year audited. Significant exception dollars are defined by strata in the table below:

Low-Risk Adequate Proposals by Auditable Dollar Value (ADV)	Amount of Previous Exception Dollars (including Corporate, Intermediate Home Office, etc) Classified as Significant
$1M or less	$15,000
$1M to $15 Million	$25,000
$15M to $50 Million	$55,000
$50 Million to $250 Million	$100,000

LOW-RISK SAMPLING PERCENTAGES

Low-risk proposals will be selected for audit using sampling techniques based on the guidance below. An adequacy evaluation must be performed prior to designating a proposal as low risk. No other audit procedures will be applied to the remaining low-risk proposals not selected for audit.

Low-Risk Adequate Proposals by Auditable Dollar Value (ADV)	Low-Risk Sampling Percentages
$1M or less	1%
$1M to $50 Million	5%
$50 Million to $100 Million	10%
$100 Million to $250 Million*	20%
Greater than $250 Million	100%

* A mandatory incurred cost audit will be performed once every three years for all proposals greater than $100 million up to $250 million. If a contractor does not have a proposal selected for audit in the 20 percent sample in a three-year cycle, the FAO shall select a proposal for audit the third year after the last audit. This selection is in addition to those incurred cost proposals selected for audit in the 20 percent sample for any given Government fiscal year.

CLOSURE METHODS TO BE USED FOR PROPOSAL CONSIDERED LOW-RISK NOT SELECTED FOR AUDIT

The following procedures will be performed on the proposals in the low-risk pool that were not selected in the sample for audit:

- Issue a Memorandum for Contracting Officer, including the key steps performed from the adequacy checklist (Enclosure 4).

- Low-risk proposals not selected in the sample for audit should be closed with disposition code "N – Assignment completed but no formal report issued" as of the date of the memorandum to the contracting officer. The proposal ADV should be reported in the "Dollars Examined Gross" field on the disposition tab in DMIS to ensure that we maintain visibility of the dollars associated with assignments closed without audit. Calculate the dollars examined using the same procedures as if an audit were performed. See page A-15 of the DMIS Users Guide for detailed procedures for calculating ADV. Costs questioned and total exception dollars will be reported as zero. The Audit, Desk Review, or No Audit field entry will be "N = No Audit" and the Audit Determined/Negotiated field entry will be "N = Negotiated."

PROCEDURES

- Upon receipt of this guidance, the FAO should identify all incurred cost proposals on hand for which the audit has not started.
- Perform an adequacy determination, if not already completed.
- All adequate incurred cost proposals exceeding $250 million in ADV will be audited.
- Proposals less than or equal to $250 million received and determined adequate will be assessed for risk. The auditor will determine whether the remaining incurred cost proposals should be included in the high-risk pool or low-risk pool using the risk assessment worksheet (Enclosure 3).
- All adequate incurred cost proposals included in the high-risk pool will be audited.
- All adequate low-risk incurred cost proposals will be randomly selected for audit based on the following sampling percentages. Regional offices in coordination with OWD will determine and document sampling plan.

    - One percent (1%) of the incurred cost proposals up to $1 million
    - Five percent (5%) of the incurred cost proposals of $1 million to $50 million included in the low-risk pool will be randomly selected for audit.
    - Ten percent (10%) of the incurred cost proposals of $50 million to $100 million included in the low-risk pool will be randomly selected for audit.
    - Twenty percent (20%) of the incurred cost proposals of $100 million to $250 million included in the low-risk pool will be randomly selected for audit. A mandatory incurred cost audit will be performed once every three years.

- Draft a memorandum to the contracting officer for those low-risk proposals not selected for audit unless the FAO has multiple proposals from the same contractor, then follow the procedures below.
- If a contractor has more than one incurred cost proposal in the initial low-risk pool, the following procedures will be used:

    - If no proposals for the contractor are selected in the sample for audit, close out all adequate incurred cost proposals that were in the sampling pool for that contractor using the procedures discussed above.
    - If one or more proposals are selected in the sample for audit, do not disposition any of the other proposals for the contractor until the audit is completed.

        - If significant questioned costs are found, audit all other incurred cost proposals that were in the sampling pool for the contractor using multi-year audit techniques.
        - If no significant questioned costs are found, close out all other proposals that were in the sampling pool using the procedures discussed above.

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION, TECHNOLOGY AND LOGISTICS

JUL 24 2012

In reply refer to
DARS Tracking Number: 2012-O0013

MEMORANDUM FOR COMMANDER, UNITED STATES SPECIAL OPERATIONS COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY (ACQUISITION AND PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (CONTRACTING)
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Class Deviation—DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals

Effective immediately, for the purposes of satisfying the audit requirements at FAR 4.804-5(a)(12), 42.705-1(b)(2), and 42.705-2(b)(2)(i), Department of Defense contracting officers shall continue to rely on either a DCAA audit report or a DCAA memorandum documenting that, based on a risk assessment and a proposal adequacy evaluation pursuant to FAR 42.705-1(b)(1)(iii), DCAA deemed the incurred cost proposal to be low-risk and did not select it for further audit in accordance with the attached DCAA Policy dated July 6, 2012.

This DCAA policy represents a continuation of a risk-based sampling process in use since 1994. It remains a prudent use of resources and contains adequate safeguards against unacceptable risk, while still ensuring that the contracting officer will have all the information needed for contract closeout.

This deviation remains in effect until it is incorporated into the FAR or DFARS or is otherwise rescinded. My point of contact is Mr. Mark Gomersall who may be reached at 571-372-6099, or mark.gomersall@osd.mil.

Richard Ginman
Director, Defense Procurement
and Acquisition Policy

Attachment:
As stated

DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

OFFICE OF THE DIRECTOR

July 6, 2012

MEMORANDUM FOR DIRECTOR, DEFENSE PROCUREMENT AND ACQUISITION POLICY

SUBJECT: Modification of DCAA Process for Sampling Low-Risk Incurred Cost Proposals

As coordinated with your office, enclosed are our policies and procedures for sampling low-risk incurred cost proposals. The policies and procedures will be implemented upon your issuance of the related Class Deviation. We believe this process will provide for a more effective oversight approach without significantly increasing risk to the Government. Should you have any questions, please contact me at (703) 767-3200.

for Patrick J. Fitzgerald
Director

Enclosure:
Policy and Procedures

DCAA Policy and Procedures for
Sampling Low-Risk Incurred Cost Proposals

POLICY

All incurred cost proposals should be evaluated upon receipt for adequacy, in accordance with FAR 52.216-7, using the DCAA Incurred Cost Proposal Adequacy checklist. If the incurred cost proposal is not adequate and the deficiencies cannot be remedied with minor effort, the proposal will be returned to the contractor with written instructions on required corrective actions, in accordance with CAM Chapter 6.

All adequate annual incurred cost proposals exceeding $250 million in auditable dollar value (ADV) will be audited. All other incurred cost proposals received and determined to be adequate will be assessed for risk. All adequate high-risk proposals will be audited.

To address the current significant backlog, low risk adequate annual incurred cost proposals (using criteria below) submitted by contractors with auditable dollar value (ADV) of $1 million or less and received prior to October 1, 2011, will not be selected for audit. A Memorandum for Contracting Officer will be issued as discussed in the following paragraphs.

CRITERIA FOR CLASSIFICATION OF PROPOSALS TO HIGH-RISK AND LOW-RISK POOLS

For all proposals with $250 million or less in ADV, FAOs should classify risk as high or low for all adequate incurred cost proposals on hand where an audit (field work) has not been started, using the criteria specified below:

Low Risk Proposal Criteria

- We have prior incurred cost audit experience (i.e., an incurred cost audit has been performed).
- No significant audit leads or no other significant risk has been identified (any known business system deficiencies that would have a significant impact on the final indirect rate proposal for this FY, significant risk identified by the contracting officer, etc.).
- No prior significant total exception dollar reported in the last year audited. Significant exception dollars are defined by strata in the table below:

Low-Risk Adequate Proposals by Auditable Dollar Value (ADV)	Amount of Previous Exception Dollars (including Corporate, Home Office, etc) Classified as Significant (gov. impact)
$1M or less	$15,000
$1M to $15 Million	$25,000
$15M to $50 Million	$55,000
$50 Million to $250 Million	$100,000

DCAA Policy and Procedures for
Sampling Low-Risk Incurred Cost Proposals

LOW-RISK SAMPLING PERCENTAGES

Low-risk proposals will be selected for audit using sampling techniques based on the guidance below. An adequacy evaluation must be performed prior to designating a proposal as low risk. No other audit procedures will be applied to the remaining low-risk proposals not selected for audit.

Low-Risk Adequate Proposals by Auditable Dollar Value (ADV)	Low-Risk Sampling Percentages
$1M or less received after 9/30/2011	1%
$1M to $50 Million	5%
$50 Million to $100 Million	10%
$100 Million to $250 Million*	20%
Greater than $250 Million	100%

* A mandatory incurred cost audit will be performed once every three years for all proposals greater than $100 million up to $250 million. If a contractor does not have a proposal selected for audit in the 20 percent sample in a three-year cycle, the FAO shall select a proposal for audit the third year after the last audit. This selection is in addition to those incurred cost proposals selected for audit in the 20 percent sample for any given Government fiscal year.

CLOSURE METHODS TO BE USED FOR PROPOSAL CONSIDERED LOW-RISK NOT SELECTED FOR AUDIT

The following procedures will be performed on the proposals in the low-risk pool that were not selected in the sample for audit:

- Issue a Memorandum for Contracting Officer, including the key steps performed from the adequacy checklist (see enclosed proforma adequacy determination letter).

- Low-risk proposals not selected in the sample for audit should be closed with disposition code "N – Assignment completed but no formal report issued" as of the date of the memorandum to the contracting officer. The proposal ADV should be reported in the dollars examined field so that the Agency can determine the value of incurred cost proposals that were not audited. Costs questioned and total exception dollars will be reported as zero. The Audit, Desk Review, or No Audit field entry will be "N = No Audit" and the Audit Determined/Negotiated field entry will be "N = Negotiated."

PROCEDURES

- Upon receipt of this guidance, the FAO should identify all incurred cost proposals on hand for which the audit has not started.

DCAA Policy and Procedures for Sampling Low-Risk Incurred Cost Proposals

- Perform an adequacy determination, if not already completed.
- All adequate incurred cost proposals exceeding $250 million in ADV will be audited.
- Proposals less than or equal to $250 million received and determined adequate will be assessed for risk. The auditor will determine whether the remaining incurred cost proposals should be included in the high-risk pool or low-risk pool using the attached risk assessment worksheet.
- All adequate low-risk incurred cost proposals less than or equal to $1 million received prior to October 1, 2011 will not be audited or sampled. Draft memorandum to the contracting officer.
- All adequate incurred cost proposals included in the high-risk pool will be audited.
- All other adequate low-risk incurred cost proposals will be randomly selected for audit based on the following initial sampling percentages. Regional offices in coordination with OWD will determine and document sampling plan.

    - One percent (1%) of the incurred cost proposals up to $1 million received after September 30, 2011, and included in the low-risk pool, will be randomly selected for audit.
    - Five percent (5%) of the incurred cost proposals of $1 million to $50 million included in the low-risk pool will be randomly selected for audit.
    - Ten percent (10%) of the incurred cost proposals of $50 million to $100 million included in the low-risk pool will be randomly selected for audit.
    - Twenty percent (20%) of the incurred cost proposals of $100 million to $250 million included in the low-risk pool will be randomly selected for audit. A mandatory incurred cost audit will be performed once every three years.

- Draft a memorandum to the contracting officer for those low-risk proposals not selected for audit unless the FAO has multiple proposals from the same contractor, then follow the procedures below.
- If a contractor has more than one incurred cost proposal in the initial low-risk pool, the following procedures will be used:

    - If no proposals for the contractor are selected in the sample for audit, close out all adequate incurred cost proposals that were in the sampling pool for that contractor using the procedures discussed above.
    - If one or more proposals are selected in the sample for audit, do not disposition any of the other proposals for the contractor until the audit is completed.

        - If significant questioned costs are found, audit all other incurred cost proposals that were in the sampling pool for the contractor using multi-year audit techniques.
        - If no significant questioned costs are found, close out all other proposals that were in the sampling pool using the procedures discussed above.

<table>
<tr><th colspan="2">DEFENSE CONTRACT AUDIT AGENCY
RISK DETERMINATION FOR CONTRACTOR YEARS WITH LESS THAN $250M IN ADV</th></tr>
<tr><td>Version No. 1.4</td><td>August 2012</td></tr>
</table>

CONTRACTOR ______________________________ **CFY** __________

LAST CFY AUDITED ____________ **AUDIT REPORT NO.** ____________________

DATE CONTRACTOR'S PROPOSAL RECEIVED ____________________________

IF THIS IS A REIMBURSABLE CONTRACTOR, DO WE HAVE AN AUDIT REQUEST? YES ____ NO ____
(If not, obtain request before further processing)

FOR CONTRACTORS WITH $100 MILLION TO $250 MILLION IN ADV, WERE ADEQUACY DETERMINATION LETTERS USED TO CLOSE TWO PRIOR CFYs (i.e., IS THIS THE THIRD UNAUDITED YEAR)?
(A "YES" response indicates proposal must be audited regardless of initial risk).

YES ________ **NO** ________

AMOUNT OF ADV __________ (000)
(per incurred cost submission)

(The audit team must use their professional judgment, combined with their knowledge of the contractor and the results of the adequacy and other reviews, to determine if there are any risks that would warrant the contractor to be classified as high risk and an audit be performed.)

<table>
<tr><th></th><th>CRITERIA</th><th></th><th>YES</th><th></th><th>NO</th></tr>
<tr><td>1.</td><td>Are there audit leads (including assist audits, corporate, intermediate home office or service center) or other significant risks identified? For example:
• any known business system deficiencies that have a significant impact on the incurred cost proposals for this fiscal year;
• significant risks identified by the contracting officer;
• significant changes in the contractor organization or operations (e.g., significant increase in ADV); or
• other significant risk identified by the audit team.

Auditors should contact contracting officers to ascertain any known concerns that may impact this assignment. Document discussions (ACO name, phone number, and date contacted.)</td><td></td><td></td><td></td><td></td></tr>
<tr><td>2.</td><td>We have no incurred cost audit experience with the contractor.</td><td></td><td></td><td></td><td></td></tr>
<tr><td>3.</td><td>Are there significant total exception dollars (as described below) in the last completed incurred cost audit?
See guidelines below for determining significance of exception dollars.</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td>Amount of Exception Dollars: $__________________________</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td colspan="4">With a "yes" response to ANY of these questions, place proposal in the high-risk pool.</td><td></td></tr>
</table>

Low-Risk Adequate Proposals by Auditable Dollar Value (ADV)	**Amount of Previous Total Exception Dollars Classified as Significant, including Corporate and Intermediate Home Office**
$1M or less	$15,000
$1M to $15 Million	$25,000
$15M to $50 Million	$55,000
$50 Million to $250 Million	$100,000

ASSIGNED TO: **LOW-RISK POOL** **HIGH-RISK POOL**

SUPERVISORY REVIEW: ____

(Supervisor's Signature and Date)

MEMORANDUM FOR CONTRACTING OFFICER

SUBJECT: Fiscal Year (FY) 20[*XX*] Adequate Incurred Cost Proposal for [*Contractor Name, Address*][*Contractor primary cage code*]

We received [*Contractor Name*]'s ([*Contractor Acronym*]) FY 20[*XX*] incurred cost proposal dated [enter date of proposal] on [enter date proposal received]. Based on the results of our adequacy evaluation, we consider the [*Contractor Acronym*]'s FY 20[*XX*] incurred cost proposal adequate in accordance with the requirements in FAR 52.216-7.

Our adequacy evaluation did not disclose any significant audit leads and during our initial coordination with your office you disclosed no concerns that would require an audit. Our adequacy evaluation included a mathematical verification and a determination that [*Contractor Acronym*]'s proposal was certified by its top management officials that it does not include unallowable costs (see Enclosure 1). Based on the adequacy evaluation and an overall assessment of low risk, we placed the [*Contractor Acronym*]'s FY 20[*XX*] incurred cost proposal in our sampling pool; it was not selected for audit.

The contractor's proposed final annual indirect cost rates for the fiscal year ended [*insert contractor's fiscal year*] are as follows:

	Proposed Allocation Base		
Cost Center	**Amount**	**Description**	**Proposed Rate**

[Note: If this is related to corporate/home office proposal, please replace the indirect rate schedule with the appropriate corporate/home office schedule.]

We discussed the results of our adequacy evaluation with [*Name and Title of Contractor's Representative*] on [*Date*].

The contracting officers may use their authority under FAR 42.705-1 to determine the [*Contractor Acronym*] FY 20[*XX*] final indirect cost rates. In addition, we recommend that the contracting officer require [*Contractor Acronym*] to adjust its interim billings on all affected contracts to reflect the settled direct and indirect costs and update its schedule of cumulative direct and indirect costs claimed and billed.

Please contact [*Auditor's Name*], Auditor, at [*E-mail and Phone Number*], if you have questions concerning this memorandum or if you require additional information.

[*FAO Manager Name*]
Branch Manager
[*FAO Name*]

Enclosure: Certificate of Final Indirect Costs

cc:
[*Contractor Name*]'s ([*Contractor Acronym*]

Milestones Plan
Low-Risk Incurred Cost Proposal Initiative
Regional/FAO Actions and Implementation Date

Steps	Implementation Plan	Completion Date
1	Complete adequacy review and risk determinations for all in house proposals from oldest to newest so that low-risk proposals can be included in sampling universes quarterly. See steps below for the dates that sample universes will be created.	January 31, 2013
2	OWD will send the first low-risk proposal sample universe to the Regions (Excel Spreadsheet). The assignments in the first universe will be coded LR4Q12 in the sample universe field. This first universe will be limited to adequate proposals less than or equal to $15M.	August 15, 2012
3	Regions will: • Review (i.e., scrub) the universe for proposals that should not be sampled (e.g., corporate and IHO proposals not properly coded in DMIS, 100% non-DoD, and audits already in process). • Then select a sample on a region-wide basis using the applicable percentage from the P&P for each universe strata (the number of sample items should be rounded up). • Update the Excel Spreadsheet (annotating the "Sample Code" column with "X" for do not include in sample universe or "Y" for selected for audit). • Submit the updated Excel Spreadsheet to OWD. • Notify FAO which proposals are selected for audit and which will be closed without audit.	September 12, 2012
4	Using the information provided by the Regions, OWD will update the sample universe and selected for audit fields in DMIS.	September 14, 2012
5	For proposals not selected for audit, FAO should issue a memo to ACO and disposition the assignment in DMIS. Time phase the memos, working from oldest to newest CFYs, so that ACOs are not inundated with too many memos at once.	August 24, 2012 – March 31, 2013
6	OWD will send the second low-risk proposal sample universe to the Regions (Excel Spreadsheet). The assignments in the second universe will be coded LR1Q13 in the sample universe field. This second universe will be limited to adequate proposals less than or equal to $100M.	November 16, 2012
7	Regions will repeat the actions from the bullets in 3 above.	December 14, 2012
8	Using the information provided by the Regions, OWD will update the sample universe and selected for audit fields in DMIS.	December 21, 2012
9	For proposals not selected for audit, FAO should issue a memo to ACO and disposition the assignment in DMIS. Time phase the memos, working from oldest to newest CFYs, so that ACOs are not inundated with too many memos at once.	January 1, 2013 – June 30, 2013

10	The process outlined above will be repeated with the third low-risk proposal sample universe (Excel Spreadsheet). The assignments in the third universe will be coded LR2Q13 in the sample universe field. This third universe will consist of all adequacy proposals less than or equal to $250M. *At this point, the number of memos issued to ACO should be reduced to a level where they can be incorporated with the remaining memos from the prior quarter's sample.*	February 15, 2013

It is imperative that auditors remember the primary objective of the initiative is to redirect audit effort to completion of high-risk and sampled incurred cost audits, beginning with the earlier year proposals first (i.e., oldest to newest). Therefore, to ensure the new policy does not adversely impact on-going audit effort, FAOs should time phase issuance of memorandums to contracting officers for proposals not selected for audit.

"Scrubbing" the HQ-OWD Initial Universe: If in doubt about whether a particular assignment should be excluded from the universe (e.g., corporate and IHO proposals not properly coded in DMIS, 100% non-DoD, and audits already in-process), update the Excel Spreadsheet "Sample Code" column with an "X". Although these assignments will be removed from the current universe, they will appear again in the next universe unless the in-process audit is completed, or the corporate audit status field is revised.

Filing of Supporting Documentation: Regions should document their universe review and sample selection process and file the documentation in Livelink under a folder named "720.9.2.7 – Incurred Cost Low-Risk Sample Selection" with subfolders for each sample.

Coordination with DCMA: FAOs should coordinate with their respective ACOs to ensure that their time phasing of memos is appropriate and adjust, based on their resources and those of the ACO.

Memos to ACOs: Once the number of memos to be issued has been reduced significantly, the expectation will be that all memos will be issued before the start of the next sampling process.

FREQUENTLY ASKED QUESTIONS
Sampling Low-Risk Incurred Cost Proposal

Question 1: Will the agency continue performing desk reviews of low-risk incurred costs proposals with less than $15M in ADV?

Answer: No. The new sampling initiative for low-risk incurred cost proposals replaces the prior policy related to performing desk reviews. For in-process desk reviews where procedures have been substantially started or completed, auditors should complete the assignment as it was planned. Under the new policy, there is no longer a mandatory third-year audit requirement for proposals with less than $15M in ADV.

Question 2: If we have five years in inventory for a contractor that we have not audited previously, can we audit first year's proposal, and if no costs are questioned, place the remaining unaudited years in the low-risk pool for sampling?

Answer: Yes. Auditors should complete the adequacy review and risk determination for all years' proposals and input high risk for all years in DMIS. On the remaining years, risk determinations should be reassessed after the 1st year's audit is completed. However, auditors should consider whether multiyear auditing may be appropriate based on their professional judgment.

Question 3: Will we still issue rate agreement letters and cumulative allowable cost worksheets for low-risk proposals not selected for audit?

Answer: No. If the low-risk proposal is not selected for audit, the auditor should issue a memorandum to the contracting officer using the proforma memorandum (Enclosure 4). Contracting officers will use their authority under the FAR 42.705-1 to establish final indirect cost rates for the contractor fiscal year and provide a copy of the rate agreement letter to the audit office. Once the contracting officer has established the final rates, auditors will continue to follow the guidance in CAM 6-711.3 and complete CACWS within 60 days of settlement of the indirect rates.

Question 4: Has the guidance changed for adjusting ADV based on subcontract cost?

Answer: No. Auditors should calculate initial ADV in accordance with current guidance. If the subcontract costs are being audited by another DCAA office, the ADV should be excluded at the prime level. Auditors should use professional judgment when assessing risk considering the materiality of the subcontract costs. Coordination between the prime auditors and the lower-tier auditors is required early in the process and should be documented and maintained in the assignment folder at both locations.

Question 5: Will incurred cost proposals that include non-DoD contracts be eligible for the low-risk sampling initiative?

Answer: Yes. During the adequacy review and risk determination process, auditors should make every effort to determine if non-DoD agencies will be participating in order to calculate the appropriate ADV. However, if the auditor is unable to verify, at the time of the high/low-risk determination, that a non-DoD agency will participate in the audit (e.g., funding is uncertain), auditors should include the non-DoD contract costs in the total ADV calculation for risk assessment purposes. However, proposals that are 100% non-DoD will not be included in the low-risk sampling process at this time.

Question 6: What if the contracting officer establishes final indirect cost rates for a proposal not selected for audit and we find significant indirect questioned costs in the next year audit. Should we go back and audit the earlier year?

Answer: No. A signed rate agreement letter is a legally binding document that is incorporated into the contract and, generally, cannot be changed without consent of both the Government and the contractor, except for rare circumstances such as fraud or mutual mistake. Auditors should communicate and share with the ACO any significant indirect questioned costs that impact prior audited years, so that the ACO can attempt to negotiate with the contractor.

Question 7: What if we find significant direct costs questioned and the contracting officer has already established the final indirect cost rates for a proposal not selected for audit? Should we go back and audit the earlier year contract costs?

Answer: Yes, provided the contract has not already been closed. The contracting officer may recover unallowable direct contract costs any time before final payment is made on the contract, in accordance with FAR 52.216-7(g) for cost reimbursable contracts, and FAR 52.232-7(f) for Time and Material contracts. Auditors should coordinate with the contracting officer in these situations.

Question 8: Can we rely on audits performed prior to 2008 in making risk classification decisions? Quality Assurance reviews have indicated that some of our audit work prior to 2008 may not have met GAGAS standards.

Answer: Yes, generally we can rely on prior audit results (e.g., incurred cost, and real-time testing) in making risk classification decisions (e.g., questioned costs in prior years), unless the specific audit we are relying on was found to be performed in non-compliance with GAGAS. However, if auditors are relying on the audit effort to support their opinion in the current audit, the auditor should ensure that the audit was performed in accordance with GAGAS.

Question 9: I am working at Field Detachment and have only direct cost audits; the indirect cost rate proposal is under the cognizance of another DCAA office. Do I have to follow this process if I audit only the direct cost portion of the proposal?

Answer: The cognizant FAO responsible for auditing the indirect cost rate proposal will perform a single adequacy review and risk determination covering the total direct and indirect ADV, in coordination with the FD office. If the proposal is low risk and not selected for audit, the cognizant FAO assignment will be dispositioned with the memorandum to the contracting officer (copy to FD). FD will disposition their assignment with a memorandum to the contracting officer.

Question 10: Are corporate, shared services and home office proposals subject to the low-risk sampling initiative?

Answer: No. Corporate, shared services and home office proposals will not be included in the low-risk sampling process. Corporate/home offices and segments should coordinate early in the process to determine if a corporate or home office audit is necessary. If, after coordination, the segment's proposal is high risk or sampled, the corporate/home office should perform the necessary audit procedures to cover the significant high-risk cost area(s) based on the coordination with segment(s). Auditors should use professional judgment, considering the materiality of the allocated costs when assessing risk. If the corporate/home office audit is not required, auditors should disposition the assignment with a memorandum to the contracting officer. All coordination efforts should be documented and maintained in the permanent file at both the Corporate/Intermediate Home Office and segment locations.

Question 11: Are subcontract proposals subject to the low-risk sampling initiative?

Answer: Yes. The low-risk sampling initiative applies to both prime contractor and subcontractor proposals. Prime contract auditors will determine the need for assist audits in accordance with current agency procedures. Subcontract auditors will follow the initiative policies and procedures, including performance of high/low-risk determinations for sampling purposes. If the subcontractor's proposal is not selected for audit, subcontract auditors should disposition the assignment with a memorandum to the contracting officer (cc: applicable prime contract or higher-tier subcontract auditors). Both prime contract auditors and subcontract auditors are reminded to coordinate early in the risk assessment process to identify any known risk that may impact the need for an audit.

Question 12: Should I classify the FY 2010 proposal as low risk when the last incurred cost audit performed was back in FY 2002?

Answer: It depends. In assessing the risk of any proposal, auditors must consider whether there are any audit leads or other significant risks identified. This may include the auditor's assessment of whether the contractor's business and organizational structure (including personnel and accounting operations), for the intervening years, has been relatively stable and consistent. When the last incurred cost audit performed is not recent, this assessment is especially important. If in your professional judgment, based on your adequacy review and other contractor information, you conclude the FY 2010 contractor operations are significantly different from the FY 2002 contractor operations, then you should classify the proposal as high risk. One example would be a material increase in ADV. If the contractor's ADV significantly increased from FY 2002 to FY 2010, we should classify the proposal as high risk. However, if in your professional judgment and building on your knowledge obtained through performance of other audit effort (e.g., provisional billing rates, public voucher processing, real-time testing of direct costs, forward pricing audits, etc.), the contractor's business and organizational structure has been relatively stable and consistent, and no audit leads or other significant risk is identified; you should classify the FY 2010 proposal as low risk.