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

IN REPLY REFER TO

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

SUBJECT: Audit Guidance on Developing a Finding in a Price Proposal Audit

SUMMARY

To ensure our audits bring the greatest possible value to the acquisition process and we deliver a quality product, the audit team should plan and perform procedures to develop elements of a finding that are relevant and necessary to achieve the audit objectives. The audit procedures may disclose that the contractor's estimate does not comply with the audit criteria (i.e., FAR Part 15) because the contractor's estimating method or the set of underlying data used to develop the estimate were incomplete or inconsistent. In these instances, the audit team should gather the appropriate evidence and perform the necessary procedures to quantify the effect of the noncompliance and report the difference as questioned costs. On occasion, this will require the audit team to identify and obtain evidence that was not used by the contractor to develop its estimate. Table 15-2 Note 2 in FAR 15.408 provides for access to all records and factual data that will permit an adequate evaluation of the proposed price, regardless of whether the data were included in the contractor's proposal. The audit team should make all practical attempts to obtain the appropriate evidence and apply the necessary procedures to determine questioned costs. If the evidence obtained from the contractor together with evidence obtained from other sources does not permit reaching a definitive conclusion on the impact of the noncompliance, the audit team should then classify the costs as unsupported. The enclosed Frequently Asked Questions (FAQ) address different pricing scenarios.

BACKGROUND

We have received questions regarding the extent to which the audit team should go in performing audit procedures on deficient contractor estimates. Consistent with CAM 9-310g, the audit team should attempt to obtain or develop information through audit means when significant deficiencies/noncompliances are identified during a price proposal audit. Some audit teams have expressed concern that developing an audit position based on data not considered in the contractor's original estimate may impair the audit team's independence. Acting on this concern, some audit teams have chosen to immediately classify all proposed costs associated with significantly deficient estimates as unsupported rather than applying the necessary procedures to develop the finding that are relevant and necessary to achieve the audit objectives and quantify the impact as questioned costs.

GUIDANCE

The audit team should develop a sound position by evaluating the contractor's cost data provided in support of its price proposal and, if necessary, other evidence available either in the contractor's files or from other reliable third-party sources. The audit team should gain a clear understanding of the audit criteria, the contractor's basis of estimate, and the underlying supporting data as soon as practical after receiving the proposal. Professional judgment must be used to determine if the proposal is sufficiently adequate for audit, following the guidance at CAM 9-204 (i.e., all reasonably available data has been submitted or identified). If the proposal is deemed adequate, or the proposal is inadequate but the contracting officer maintains the request for audit (see CAM 9-205d), the audit team should design procedures in order to detect noncompliance with the audit criteria (e.g., FAR 15/31). If the estimating method and/or the condition of the underlying data have caused the proposal not to meet the audit criteria, the audit team should follow the "Rules of Engagement" and immediately discuss the potential noncompliance with the contractor to ensure an accurate understanding. If a noncompliance is identified, the audit team should plan and perform procedures to develop the elements of the finding that are relevant and necessary to achieve the audit objectives (2011 GAGAS 5.11).

One of the key elements of a finding discussed in GAGAS is the *effect.* The *effect* is the difference between the contractor's estimate and an estimate that complies with the audit criteria. Presenting the effect serves to establish the impact of the finding. In many cases, the effect can be determined by using the proposal data provided by the contractor and applying the applicable audit criteria. For example, a quote furnished by the contractor shows a quantity discount not considered in the proposed value and the audit team concludes that the estimate does not comply with the reasonableness criteria found in FAR 31.201-3 and 31.205-26(b)(1) requirement to take advantage of available discounts. In quantifying the *effect*, the audit team determines the difference between the proposed value and the quoted price adjusted to reflect the discount, and reports the difference as questioned costs.

Fully developing a finding of noncompliance may require evidence that is neither included with the proposal nor referenced. The audit team can and should request additional documentary evidence considered necessary to fully develop the finding. Table 15-2 Note 2 at FAR 15.408 provides for access to *books, records, documents, and other types of factual data (regardless of form or whether the data are specifically referenced or included in the proposal as the basis for pricing) that will permit an adequate evaluation of the proposed price*. The audit team should take the necessary steps to identify and obtain the evidence needed from the contractor, which may include requesting assistance from the ACO and/or PCO (CAM 10-304.8c). If the needed records are denied, resolution should be pursued following the guidance at CAM 1-504.5.

The audit team is not limited to contractor-furnished data in developing a finding. It may be necessary to obtain data from third-party sources to determine the quantified effect of noncompliance (e.g., valid catalog pricing offered by alternative vendor). Regardless of the

source of the audit evidence, the audit team should make every practical effort to fully develop the effect of noncompliance and present the amount in the report Exhibit as questioned costs. Developing the elements of an audit finding that are relevant and necessary to achieve the audit objectives does not impair auditor independence.

When we have made all practical attempts to obtain the appropriate evidence and apply the necessary procedures, yet the audit team is still unable to reach a definitive conclusion on the proposed costs because the evidence is incomplete or otherwise inadequate, the team should report any questioned costs that could be identified, and report unsupported cost where the evidence remains incomplete or inadequate. This approach optimizes the audit team's ability to render an informed audit opinion while providing report users with as much information as possible to assist the Government in reaching a fair and reasonable price.

CLOSING REMARKS

Policy wishes to recognize the Forward Pricing 2A-5 Ad Hoc Committee for assisting with the development of this audit guidance.

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.

/Signed/
Donald J. McKenzie
Assistant Director
Policy and Plans

Enclosure:
Frequently Asked Questions

DISTRIBUTION: E

FREQUENTLY ASKED QUESTIONS

Question 1: The proposal we are auditing includes a subcontract under a Long Term Agreement (LTA). On review of the LTA documents, we found that the LTA term had expired. Is it appropriate to cease the audit evaluation and classify the entire proposed subcontract cost as unsupported?

Answer: No. You should work to fully develop the audit finding which, at the very least, would call for further discussion and inquiry with the contractor. It is likely that additional evidence is available in the contractor's records or from third-party sources that could be used to determine whether the proposed subcontract price is reasonable (e.g., a revised agreement, recent purchase order placed for the same item with another vendor, third-party catalog pricing). If the cost is no longer reasonable, every practical effort should be made to quantify the effect based on the facts and evidence. You should report any questioned costs identified. You may have to classify the remaining LTA costs as unsupported, if you were unable to gather sufficient evidence to support the pricing of the item being acquired (e.g., adequate cost/price analysis of a new LTA being worked, recent purchases of the same or similar items, third-party catalog pricing, etc).

Question 2: We initially determined a proposal to be adequate, but during the field work we discovered significant certified cost or pricing data inadequacies causing us to conclude that the proposal is inadequate. Since we have already sent the acknowledgement letter, must we continue auditing the proposal to the maximum practical extent?

Answer: No. Since the deficiencies are considered significant, you should immediately notify the contracting officer that the proposal is inadequate and recommend that he/she return the proposal to the contractor for corrective action. The audit team should strive to identify significant proposal inadequacies as soon as possible, but not all inadequacies are discernible before beginning the fieldwork. Coordination should occur immediately after discovering that significant proposal deficiencies exist. The audit team should make every effort to work out an agreement with the contracting officer and contractor to get the inadequacies corrected and allow audit effort to continue on other parts of the proposal. This will help to ensure the greatest value is brought to acquisition by the audit team and the acquisition cycle time is not unduly extended.

Question 3: The contractor's basis of estimate for a selection of items valued at under $700,000 on the Bill of Material is competitive pricing. We found that a significant number were supported by a single quote. Since the contractor's support is not consistent with the stated basis of estimate, can we report the costs as unsupported without any additional effort?

Answer: No, not without taking additional steps to develop the audit finding. First, you should discuss the preliminary conclusions with the contractor and inquire about additional evidence that may be available. Consideration should be given to observing the purchase file to determine the companies to which a solicitation was sent, the number of quotes received, and the follow-up actions taken to ensure reasonable competition. Other evidence may be available in the contractor's purchase order history, as well as publicly available catalog pricing.

The difference between the proposed price for each estimate and the most reasonable value based on the available evidence should be reported as questioned costs. Unless there is no available evidence it is highly unlikely that you would need to unsupport these items.

Question 4: Same question above, except the evaluation concludes that the item to be purchased is only offered by a single source. Then, should we classify the proposed cost as unsupported?

Answer: No, not without first attempting to apply additional audit procedures to develop the finding. The contractor is not relieved of its responsibility to demonstrate price reasonableness because an item is considered sole source. You should obtain and evaluate the documentation on which the contractor concluded that the subcontract price is reasonable. This may include a price analysis or an analysis of the subcontractor's proposed costs by element, regardless of whether the value is under the certified cost or pricing data threshold. In the case of material sole source subcontracts, the contractor may find that a review of uncertified cost data may be the only means by which to determine if the price is reasonable. You may also conduct an evaluation using the contractor's purchase history with the subcontractor or third-party sources of pricing information (DoD EMALL, WebFlis), etc.

Question 5: A prime contractor has not yet completed its required cost analysis on a significant subcontract but they have completed the price analysis. Should we evaluate the price analysis and assess the need for an assist audit despite the fact that all the evidence is not yet available?

Answer: Yes. In addition, you should immediately inquire about the scheduled completion date of the required cost analysis and notify the contracting officer if the expected completion date is likely to preclude audit evaluation of the contractor's cost analysis prior to report issuance. If an assist audit is obtained and the cost analysis continues to be delinquent, you should report any questioned amounts resulting from the evaluation of the price analysis and the assist audit, and classify the balance of the subcontract as unsupported. When briefing the contracting officer on the audit results, the audit team should inform the contracting officer that while we report these costs as unsupported due to the noncompliance with FAR 15, the unsupported costs can be resolved by ensuring the completed cost/price analysis is considered during negotiations or fact-finding.

Question 6: My proposal includes a subcontract valued over $700,000 and the contractor has not yet completed its required cost/price analysis. Can we develop an audit finding using the records available to us without necessarily requesting an assist audit?

Answer: Yes. There are many factors to consider in determining the need for an assist audit, including the availability of sufficient evidence. For example, your review of historical purchases and negotiation documents between the contractor and this subcontractor may provide you with sufficient evidence to identify and report questioned costs (i.e., applying a historical decrement). However, if the contractor has not yet completed its required cost/price analysis at the conclusion of the audit, the balance of the proposed subcontract cost should be reported as unsupported. The audit team should also consider issuing a deficiency report if the contractor is not using historical experience, including historical vendor pricing data, in accordance with the DFARS estimating system requirements at 252.215-7002(d)(4)(ix).

Question 7: A proposal we are examining includes significant direct labor hours based on engineering estimates, despite the fact that this is a follow-on contract. The contractor contends that the historical hours are not representative of future performance due to design changes directed by the request for proposal. We disagree with the estimating method, believing that historical direct labor hours should be considered. If we use the historical hours to help determine the reasonableness of the proposed hours, we would essentially be fixing the contractor's proposal, which would require a lot of time and possibly impair our independence. Is it appropriate to classify the proposed labor hours as unsupported because the estimating method is flawed?

Answer: No. First, you should gather evidence to evaluate the contractor's estimating method. If the evidence indicates that historical labor hours, properly adjusted for the effect of validated design changes should have been considered in the estimate, you should use the historical labor hours to fully develop the audit finding. The audit team may disagree with an estimating method, which often requires obtaining and evaluating evidence not used by the contractor to develop its estimate. While the estimating method may not necessarily be a FAR 15 noncompliance, the audit procedures may disclose a portion of the contractor's labor hour estimate is unreasonable (e.g., FAR 31.201-3). The audit team should also consider the need to issue a deficiency report for noncompliance with the DFARS Estimating System Requirements (e.g., DFARS 252.215-7002(d)(4)(ix)). In addition, the auditor is reminded that developing the elements of an audit finding that is relevant and necessary to achieve the audit objectives should not be considered "fixing" the contractor's proposal and does not impair auditor's independence.

Question 8: We are auditing a firm-fixed price proposal with a four-year performance period. The proposed indirect rates for Year 1 are based on detailed budgetary data. Year 2 rates are based on the initial year, adjusted for anticipated cost fluctuations. The rates for Year 3 and Year 4 are identical to the proposed Year 2 rates. The proposal did not include narrative rationale in support of the flat lined rates for Years 3 and 4. We are prepared to apply audit procedures to Year 1 and Year 2 rates. However, since there is no rationale or trend data in support of Year 3 and Year 4 rates, shouldn't we immediately begin planning to report the related Year 3 and Year 4 costs as unsupported?

Answer: No, not yet. You should first ask the contractor to present the set of facts supporting its estimating approach and evaluate any significant underlying evidence. If the evidence in support of Year 3 and Year 4 indirect rates is incomplete or inadequate, you should discuss with other members of the audit team the practicality of employing alternative methods in order to develop the audit finding. For example, you may plan to obtain reliable historical trend data and apply regression analysis. However, you must exercise professional judgment in determining whether the evidence is reasonably reliable and complete. If it is apparent that the historical data is not reasonably representative of Year 3 and Year 4, or evidence concerning key management decisions having a potential significant affect on future cost performance is substantially lacking, you may determine that developing the finding is impractical and unsupporting the costs for those years may be appropriate.