



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
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PSP 730.5.01.A/2018-009

November 27, 2018
18-PSP-006(R)

**MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
CORPORATE AUDIT DIRECTORS, DCAA
ASSISTANT DIRECTORS, HQ, DCAA**

SUBJECT: Audit Guidance on Revised Treatment of Incomplete or Inadequate Prime Contractor Cost or Price Analyses

This memorandum provides revised guidance on the treatment of incomplete or inadequate prime/higher-tier contractor cost or price analyses during a forward pricing proposal audit. Further, this memorandum cancels the guidance previously established in MRD 09-PSP-011(R), dated June 30, 2009, and MRD 17-PSP-007(R), dated September 6, 2017.

What are the Significant Changes?

Effective immediately, if the prime/higher-tier contractor has not completed the required cost or price analyses, or if the completed cost or price analyses are inadequate, the audit team should perform alternative procedures to establish a reasonable basis for the audit opinion. The audit team should not classify the associated costs as unsupported unless the audit team is unable to obtain sufficient appropriate evidence through performing alternative procedures.

Planning and Field Work Requirements

FAR 15.404-3(b), *Subcontract pricing considerations*, requires the prime contractor or higher-tier contractor conduct appropriate cost or price analyses to establish the reasonableness of the proposed subcontract prices. It also requires that the prime contractor include the results of these analyses in its proposal. Therefore, the audit of the prime/higher-tier contractor's proposal should include audit procedures to (1) determine if the prime/higher-tier contractor completed the required cost or price analyses of its subcontractors in accordance with FAR 15.404-3(b), and (2) evaluate the adequacy of the prime/higher-tier contractor's analyses. The audit team should gather information through inquiries, analyses, and analytical procedures to validate and confirm the adequacy of the prime/higher-tier contractor's analyses.

If the prime/higher-tier contractor has not completed the required cost or price analyses or if the completed cost or price analyses are inadequate, the audit team should perform alternative procedures to establish a reasonable basis for the audit opinion. Depending on the overall risk and materiality, the audit team can consider a variety of procedures including, but not limited to, the following:

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Contractor Cost or Price Analyses

- Create a decrement based on purchase order history;
- Create a decrement based on other relevant information (e.g., comparisons of prior subcontract proposals to historical cost or price analyses or negotiated amounts); and/or
- Coordinate with the subcontract audit team and request a DCAA assist audit based on the prime/higher-tier audit team's risk assessment.

The audit team should apply professional judgment in determining the alternative procedure(s) and substantive test(s) to perform to ensure it obtains sufficient evidence.

In addition to performing alternative procedures, the audit team should notify the Contracting Officer/requestor of the FAR noncompliance as soon as possible. The timely communication of noncompliances and deficiencies helps to ensure procurement officials are aware of issues that may affect negotiations and influence procurement milestone requirements or acquisition lead time.

Reporting Requirements

The performance of alternative procedures or receipt of an assist audit does not relieve the prime/higher-tier contractor from its FAR 15 responsibility to perform cost or price analyses of its subcontract proposal(s). As such, the audit report should identify amounts associated with incomplete or inadequate cost or price analyses as a material noncompliance (i.e., noncompliance with FAR 15.404-3(b)). However, the audit team should ***not*** classify the costs as unsupported unless it is unable to obtain sufficient appropriate evidence through performing alternative procedures.

For those cost or price analyses not received by fieldwork completion, the prime/higher-tier contract audit team should request the contractor's completion schedule and include the schedule in an Exhibit entitled, "FAR 15 Noncompliance: Subcontracts Requiring Contractor Cost/Price Analyses." The Exhibit should include the names of the subcontractors, proposed amounts, and the following explanatory note:

"FAR 15.408, Table 15-2 requires prime contractors and higher-tier subcontractors to conduct price analysis of all subcontractor proposals and a cost analysis of each subcontract proposal for which certified cost or pricing data are required. We informed [insert name(s) of ACO/PCO or representatives] on [insert date] of the contractor's planned schedule for completing the analyses. As of [insert date field work completed], [insert contractor's name] had not completed the required analyses for the subcontractors listed above. The contractor's scheduled date for completing the analyses is [insert revised date(s)]. These analyses should be submitted to the contracting officer prior to completion of prime contract negotiations."

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If the audit team is unable to obtain sufficient appropriate evidence through the performance of alternative procedures, the audit team should classify the associated costs as unsupported and include both a material noncompliance (i.e., noncompliance with FAR 15.404-3(b)) and a scope limitation in the “Basis for the Audit Opinion” section of the audit report.

Questions and Further Information

FAO personnel with questions regarding this audit guidance should contact their regional offices. Regional personnel with questions regarding this audit guidance should contact Ms. Poppy Greer, Program Manager, Pricing and Special Projects Division at (571) 448-3199 or Ms. Jennifer Kang, Chief, Pricing and Special Projects Division at (571) 448-3319 or via e-mail at DCAA-PSP@dcaa.mil.

/Signed/

Martha E. McKune

Assistant Director, Policy and Plans

Enclosure:

Frequently Asked Questions on Cost and Price Analyses

DISTRIBUTION: E

FREQUENTLY ASKED QUESTIONS COST AND PRICE ANALYSES

Question 1: Does the performance of alternative procedures or an assist audit relieve the prime/higher-tier contractor from its responsibility to perform cost or price analyses of the subcontract proposal?

Answer: No. The performance of alternative procedures or an assist audit of the subcontract proposal does not relieve the prime/higher-tier contractor of its responsibilities. FAR 15.404-3(b), *Subcontract pricing considerations*, requires prime contractors and higher-tier subcontractors to conduct appropriate cost or price analyses to establish the reasonableness of the proposed subcontract prices. It also requires the prime/higher-tier contractor to include the results of these analyses in its price proposal. Therefore, the audit team should include amounts associated with incomplete or inadequate cost or price analyses as a material noncompliance (i.e., noncompliance with FAR 15.404-3(b)) in the audit report. However, the audit team should not classify the proposed costs as unsupported or include a scope limitation unless the alternative procedures do not result in sufficient appropriate evidence.

Question 2: If the prime/higher-tier contractor is denied access to the subcontractor's cost data, does the prime/higher-tier contractor have to perform any analysis of the subcontractor's proposal?

Answer: Yes. At a minimum, the prime/higher-tier contractor should (1) perform and document its efforts to complete the FAR 15.404-1(b) required price analysis of its subcontractors, and (2) coordinate with the contracting officer to obtain any necessary audit/pricing support from the Government.

Question 3: Under what conditions should the prime/higher-tier contract audit team consider requesting a subcontract assist audit?

Answer: Based on the overall risk assessment, the audit team may consider an assist audit under many circumstances including, but not limited to, the following:

- The prime/higher-tier contractor's analysis of the subcontract cost is not complete or expected to be complete prior to fieldwork completion;
- Current data is not sufficient to provide a satisfactory basis for evaluating the reasonableness of the subcontract estimate (e.g., the prime/higher-tier's cost analysis is inadequate);
- The prime/higher-tier's policies and procedures are inadequate or the actual procedures do not conform to prescribed procedures;
- There is a business relationship not conducive to an arm's-length transaction;
- The subcontract is a significant/material portion of the proposal; and/or
- The prime is denied access to the subcontractor's books and records.

Question 4: If the prime/higher-tier contract audit team needs to request an assist audit, what steps should the audit team take?

Answer: If an assist audit is needed, the audit team should coordinate with stakeholders as soon as possible. The audit team should communicate with both the buying command and DCMA to determine whether an assist audit has already been requested. If an assist audit has not been requested, the audit team should communicate the need for audit to the Procuring Contracting Officer and request an assist audit as soon as possible. The request for assist audit should be documented in the working papers and accompanied by copies of:

- The subcontractor's proposal, along with all related cost, pricing, and pertinent technical data; and
- The results and supporting data from the prime contractor's evaluation of the subcontractor's proposal, if available.

Question 5: If the prime/higher-tier contractor has performed the FAR 15.404-3(b) required cost or price analyses to establish the reasonableness of proposed subcontract prices, and an assist audit has been requested due to additional conditions (e.g., inadequate cost or price analyses, materiality of the subcontract, customer concerns, etc.), how should the subcontract costs be presented in the prime/higher-tier contract audit report?

Answer: If the prime/higher-tier contract audit team has not received the assist audit, the applicable proposed amounts should be classified as unresolved. If the prime/higher-tier contract audit team has received the assist audit, the results should be incorporated into the prime/higher-tier contract audit report (i.e., costs questioned in the subcontract audit should be questioned in the prime/higher-tier contractor proposal audit report).

Question 6: If the prime/higher-tier contractor has not performed the FAR 15.404-3(b) required cost or price analyses to establish the reasonableness of proposed subcontract prices, and an assist audit has been requested, how should the subcontract costs be presented in the prime/higher-tier contract audit report?

Answer: If the prime/higher-tier contract audit team has not received the assist audit, the applicable proposed amounts should be classified as unresolved, and the prime/higher-tier contract audit team should include a scope limitation in the "Basis for the Audit Opinion" section. If the prime/higher-tier contract audit team has received the assist audit, the results should be incorporated into the prime/higher-tier contract audit report (i.e., costs questioned in the subcontract audit should be questioned in the prime/higher-tier contractor proposal audit report). Regardless of assist audit receipt, for those cost or price analyses required by FAR 15.404-3(b) that are not completed by fieldwork completion, the prime/higher-tier contract audit team should include a material noncompliance (i.e., noncompliance with FAR 15.404-3(b)) in the "Basis for the Audit Opinion" section. Additionally, the audit team should determine the contractor's completion schedule, and the audit report should include the completion schedule in an Exhibit entitled, "FAR 15 Noncompliance: Subcontracts Requiring Contractor Cost/Price Analyses."

Question 7: Under what circumstances should the prime/higher-tier contract audit team classify proposed subcontract costs as unsupported?

Answer: The prime/higher-tier contract audit team should classify proposed subcontract costs as unsupported only when the audit team is unable to obtain sufficient appropriate evidence through the performance of alternative procedures. In addition to classifying those costs as unsupported, the audit team should include both a material noncompliance (i.e., noncompliance with FAR 15.404-3(b)) and a scope limitation in the audit report (“Basis for the Audit Opinion” section). Furthermore, the audit team should determine the contractor’s completion schedule, and the audit report should include the completion schedule in an Exhibit entitled, “FAR 15 Noncompliance: Subcontracts Requiring Contractor Cost/Price Analyses.”