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IN REPLY REFER TO

PAC 730.3. B

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

SUBJECT: Revised Audit Guidance on the Cost Impact Calculation for a Unilateral Cost Accounting Practice Change

What are the changes?

- When calculating the increased cost to the Government "*in the aggregate*" for a unilateral cost accounting practice (CAP) change, auditors should not automatically combine impacts of fixed price and flexibly priced contract and subcontract groups.
- Special consideration is needed when a unilateral CAP change results in increased cost to both the flexibly priced and/or fixed price contract/subcontract groups to ensure the estimated increased cost to the Government "*in the aggregate*" is equitable.
- DCAA will no longer recommend settlement alternatives. It is the Cognizant Federal Agency Official's (CFAO)'s responsibility to administer the resolution of cost impacts.
- The DCAA Contract Audit Manual (CAM) 8-503 Guidance on Evaluation of Cost Impact Proposals and the Cost Impact Statement (Price Adjustment) audit program have been updated to reflect the change in guidance.

The change in guidance for cost impact calculations only applies to a single unilateral CAP change. The cost impact methodology for required and desirable CAP changes and Cost Accounting Standards (CAS) noncompliances has not changed.

When are the changes effective?

The changes are effective as of the date of this memorandum. Any ongoing CAS cost impact audits should use this new guidance when reporting the increased cost to the Government in the aggregate resulting from a unilateral CAP change.

Why did we revise the guidance?

We implemented this change in audit guidance to reflect certain Armed Services Board of Contract Appeals (ASBCA) decisions and their application to the range of unilateral CAP change scenarios, and to highlight the importance of understanding the nature of the unilateral CAP change and how it will affect future measurement, assignment, and allocation impacting accumulation and reporting of cost on Government contracts/subcontracts.

Background

The contractor may elect to implement a unilateral CAP change; however, the Government will not pay increased cost because of the CAP change (FAR 30.603-2 and 48 CFR 9903.201-4). The estimated impact to the Government is calculated by comparing the estimate to complete (ETC) on affected CAS-covered contracts/subcontracts using the new cost accounting practice to the ETC using the old cost accounting practice. Increased costs in the aggregate represent the total amount owed to and to be recovered by the Government resulting from the unilateral CAP change. A unilateral CAP change affects fixed price and flexibly priced contracts differently. On a flexibly priced contract, the increased or decreased costs allocated due to a unilateral CAP change are accumulated on the contract and the Government actually pays or receives the benefit of those changes. However, the price of a fixed price contract does not change absent a modification to the contract.

Audit Guidance

The audit team should evaluate the unilateral CAP change to understand the type of CAP change (measurement of cost, assignment of cost to cost accounting period, or a change to the methodology or technique for allocation of cost to cost objectives), the universe of all affected CAS-covered contracts/subcontracts, the movement of cost among contract/subcontract groups and customers, and all business units impacted by the unilateral CAP change. The contractor's basis for the ETC amounts for the new cost accounting practice and the old cost accounting practice must be applied prospectively from the effective date of the change through the end of contract/subcontract performance.

The first three cost impact calculation steps described in FAR 30.604(h)(3)(i)-(iii) ((i) impact to flexibly priced contracts/subcontracts; (ii) impact to fixed price contracts/subcontracts; and (iii) impact on incentives, fees, and profits) will continue to be performed. However, the fourth step in FAR 30.604(h)(iv) to calculate the increased cost to the Government *in the aggregate,* is more than just a mathematical calculation. The audit team should not simply add the impacts calculated for the fixed price and flexibly priced contract/subcontract groups; rather, the audit team should assess the nature and type of the unilateral CAP change to determine the difference between the amount paid by the Government on affected contracts/subcontracts in total using the new cost accounting practice compared to what it would have paid absent the unilateral CAP change.

The scenarios in the table below and subsequent notes and illustrations represent the cost impact to CAS-covered contract/subcontract groups resulting from a unilateral CAP change.

Change in ETC Cost Accumulation	**Increased/(Decreased) Cost (FAR 30.604(h)(3)(i), (ii) & (iii))**	**Increased Cost in the Aggregate (*)**	**Notes**
Increased ETC on Flex, Decreased ETC on Fixed	Increased Cost on Flex and Fixed	Increased cost to the Government is calculated by combining across contract/subcontract groups, less duplicated cost due to cost shifts	(1)
Increased ETC on Flex and Fixed	Increased Cost on Flex, Decreased Cost on Fixed	Increased cost to the Government on flexibly priced contracts/subcontracts	(2)
Decreased ETC on Flex and Fixed	Decreased Cost on Flex, Increased Cost on Fixed	Increased cost to the Government is calculated by combining across contract/subcontract groups	(3)
Decreased ETC on Flex, Increased ETC on Fixed	Decreased Cost on Flex and Fixed	None	(4)

**Describes the increased cost to the Government, in the aggregate, using the cost impact based on the application of FAR 30.604(h)(3). See notes below for further explanation.*

Notes:

(1) Increased Cost to the Government on Flexibly Priced and Fixed Price: When the unilateral CAP change results in decreased ETC for the fixed price CAS-covered contract/subcontract group, and increased ETC for the flexibly priced CAS-covered group (both **increased** cost to the Government), the cost impact to the Government, *in the aggregate*, will generally be the greater of the two individual group (fixed or flex) cost impact amounts. This is based upon the assumption that the unilateral CAP change resulted in the same costs being shifted from the affected fixed price contracts/subcontracts to the affected flexibly priced contracts/subcontracts. When this occurs, we should only count the same costs as “increased costs” once to eliminate the potential for "double counting" and/or "windfall profits." The following illustrations (1.A, 1.B, and 1.C) show the methodology used to determine increased cost to the Government, in the aggregate, when there is increased cost to both the fixed price and flexibly priced CAS-covered contract/subcontract groups. In each of these scenarios, the auditor should

confirm whether the unilateral CAP change shifted the same costs from the fixed price to the flexibly priced contracts/subcontracts group.

Scenario 1.A: Increased Cost for BOTH Fixed Price & Flexibly Priced: Same Value

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 75	$ 100	$ (25)	$ 25	$ -	
Flexibly Priced - CAS-covered	125	100	25	25	-	
Non-CAS-covered	100	100	-	-	-	
Subtotal	$ 300	$ 300	$ -	$ 50	$ -	***$ 25***

In scenario 1.A, the unilateral CAP change resulted in a $25 cost reduction to the fixed price contract group ETC, an additional $25 of costs to the flexibly priced contract group ETC, and no change to the non-CAS-covered contract group ETC. When determining the increased cost in the aggregate, the key is to eliminate any duplication of the same costs and recover the increase to the Government only once. The auditor should total the increased cost to the Government, $50, then reduce that amount by any confirmed shift of the same costs from the fixed price to the flexibly priced contract group. The auditor validated that the same $25 was shifted from the fixed price group to the flexibly priced contract group; accordingly, the increased costs, *in the aggregate,* resulting from the unilateral CAP change is $25.

Scenario 1.B: Increased Cost for BOTH Fixed Price & Flexibly Priced: Fixed > Flex

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 50	$ 100	$ (50)	$ 50	$ -	
Flexibly Priced - CAS-covered	125	100	25	25	-	
Non-CAS-covered	125	100	25	-	-	
Total	$ 300	$ 300	$ -	$ 75	$ -	***$ 50***

In scenario 1.B, the unilateral CAP change resulted in a $50 cost reduction to the fixed price contract group ETC, and an additional $25 of costs to the flexibly priced ETC and the non-CAS-covered contract group ETC. When determining the increased cost in the aggregate, the key is to eliminate any duplication of the same costs and recover the increase to the Government only once. The auditor should total the increased cost to the Government, $75, then reduce that amount by any confirmed shift of the same costs from the fixed price to the flexibly priced contract group. The auditor validated that $25 of the $50 reduction on fixed price contracts/subcontracts was shifted to flexibly priced contracts/subcontracts; accordingly, the increased costs, *in the aggregate,* resulting from the unilateral CAP change is $50.

Scenario 1.C: Increased Cost for BOTH Fixed Price & Flexibly Priced: Fixed < Flex

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 75	$ 100	$ (25)	$ 25	$ -	
Flexibly Priced - CAS-covered	150	100	50	50	-	
Non-CAS-covered	75	100	(25)	-	-	
Total	$ 300	$ 300	$ -	$ 75	$ -	***$ 50***

In scenario 1.C, the unilateral CAP change resulted in a $25 cost reduction to the fixed price and non-CAS-covered contract group ETC and an additional $50 of costs to the flexibly priced contract group ETC. When determining the increased cost in the aggregate, under these circumstances, the key is to eliminate any duplication of the same costs and recover the increase to the Government only once. The auditor should total the increased cost to the Government, $75, then reduce that amount by any confirmed shift of the same costs from the fixed price to flexibly priced contract group. The auditor validated that $25 of the $50 reduction on fixed price contracts/subcontracts was shifted to flexibly priced contracts/subcontracts; accordingly, the increased costs, *in the aggregate*, resulting from the unilateral CAP change is $50.

(2) Increased Cost to the Government on Flexibly Priced and Decreased Cost on Fixed Price: When the unilateral CAP change results in increased ETC for the flexibly priced CAS-covered contract/subcontract group (**increased** cost to the Government), and increased ETC for the fixed price CAS-covered contract/subcontract group (**decreased** cost to the Government), the cost impact to the Government, *in the aggregate*, will generally be the increased cost amount on the flexibly priced CAS-covered contract/subcontract group. In this situation, the increased costs on flexibly priced contracts/subcontracts will be realized by the Government in the form of higher actual billings, while the fixed prices/billings on fixed price CAS-covered contracts/subcontracts remain the same. The contractor is not entitled to offset the deemed "decreased costs" for the fixed price contract/subcontract group against the actual increased costs that will be paid on flexibly priced contracts/subcontracts as a result of the change. Such an offset would result in increased cost to the Government (48 CFR 9903.306(c) and 48 CFR 9903.201-4). The following illustrations (2.A, 2.B, and 2.C) show the methodology used to determine increased cost to the Government in the aggregate.

Scenario 2.A: Decreased Fixed Price Cost & Increased Flexibly Priced Cost: Same Value

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 125	$ 100	$ 25	$ -	$ 25	
Flexibly Priced - CAS-covered	125	100	25	25	-	
Non-CAS-covered	50	100	(50)	-	-	
Total	$ 300	$ 300	$ -	$ 25	$ 25	***$ 25***

In scenario 2.A, the unilateral CAP change resulted in an additional $25 of ETC to both the fixed price and flexibly priced contract groups, as well as a $50 cost reduction to the non-CAS-covered contract group ETC. The contractor is not entitled to offset the $25 "decreased costs to the Government" for the fixed price contract/subcontract group against the actual $25 increased costs to the Government that will be paid on flexibly priced contracts/subcontracts as a result of the change. Accordingly, the increased cost, *in the aggregate,* under these circumstances is the actual $25 of increased cost to the Government on the flexibly priced contract group.

Scenario 2.B: Increased Flexibly Priced Cost More than Decreased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 125	$ 100	$ 25	$ -	$ 25	
Flexibly Priced - CAS-covered	150	100	50	50	-	
Non-CAS-covered	25	100	(75)	-	-	
Total	$ 300	$ 300	$ -	$ 50	$ 25	***$ 50***

In scenario 2.B, the unilateral CAP change resulted in an additional $25 of ETC on the fixed price contract group, an additional $50 of ETC on the flexibly priced contract group, and a $75 cost reduction to the non-CAS-covered contract group ETC. The contractor is not entitled to offset the $25 "decreased costs to the Government" for the fixed price contract/subcontract group against the actual $50 increased costs to the Government that will be paid on flexibly priced contracts/subcontracts as a result of the change. Accordingly, the increased cost*, in the aggregate,* under these circumstances is the actual $50 of increased cost to the Government on flexibly priced contract groups.

Scenario 2.C: Increased Flexibly Priced Cost Less than Decreased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 150	$ 100	$ 50	$ -	$ 50	
Flexibly Priced - CAS-covered	125	100	25	25	-	
Non-CAS-covered	25	100	(75)	-	-	
Total	$ 300	$ 300	$ -	$ 25	$ 50	***$ 25***

In scenario 2.C, the unilateral CAP change resulted in an additional $50 of ETC on the fixed price contract group, an additional $25 of ETC on the flexibly priced contract group, and a $75 cost reduction to the non-CAS-covered contract group ETC. The contractor is not entitled to offset the $50 "decreased costs to the Government" for the fixed price contract/subcontract group against the actual $25 increased costs that will be paid on flexibly priced contracts/subcontracts because of the change. Accordingly, the increased cost*, in the aggregate,* under these circumstances is the actual $25 of increased cost to the Government on flexibly priced contract groups.

(3) <u>Decreased Cost to the Government on Flexibly Priced and Increased Cost to the Government on Fixed Price</u>: When the unilateral CAP change results in decreased ETC on the flexibly priced CAS-covered contract/subcontract group (**decreased** cost to the Government) and increased ETC on the fixed price CAS-covered contract/subcontract group (**increased** costs to the Government), the cost impact to the Government, *in the aggregate*, will generally be limited to the excess of the increased fixed price CAS-covered contract/subcontract group over the decreased flexibly priced CAS-covered contract/subcontract group. Under this scenario, fewer costs will be accumulated on both the fixed and flexibly priced CAS-covered contract/subcontract groups. The decreased costs on flexibly priced contracts/subcontracts will be realized in the form of fewer actual cost accumulations and billings and therefore should be included in the calculation of the increased cost in the aggregate. The decrease in cost accumulations on fixed price contracts/subcontracts represents an increase cost to the Government. If the new cost accounting practice had been used to negotiate the fixed price contracts/subcontracts, the negotiated price would have been lower. The contractor is not entitled to additional profits because of a unilateral CAP change; therefore, the Government must be made whole by the amount of the lower fixed price contract/subcontract amounts due to the unilateral CAP change. The following illustrations (3.A, 3.B, and 3.C) show the methodology used to determine increased cost to the Government in the aggregate.

Scenario 3.A: Decreased Flexibly Priced Cost More than Increased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 75	$ 100	$ (25)	$ 25	$ -	
Flexibly Priced - CAS-covered	50	100	(50)	-	50	
Non-CAS-covered	175	100	75	-	-	
Total	$ 300	$ 300	$ -	$ 25	$ 50	**$ -**

In scenario 3.A, the unilateral CAP change resulted in a $25 cost reduction to the fixed price contract group ETC, $50 cost reduction to the flexibly priced contract group ETC, and $75 of additional costs on the non-CAS-covered contract group ETC. The increased cost to the Government, *in the aggregate,* would be zero. The contractor would continue to bill the negotiated $100 fixed price contract group amount ($25 additional profit) but would only bill the $50 incurred on the flexibly priced contract ($50 cost reduction) resulting in an overall decrease of costs to the Government.

Scenario 3.B: Decreased Flexibly Priced Cost Less than Increased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 50	$ 100	$ (50)	$ 50	$ -	
Flexibly Priced - CAS-covered	75	100	(25)	-	25	
Non-CAS-covered	175	100	75	-	-	
Total	$ 300	$ 300	$ -	$ 50	$ 25	**$ 25**

In scenario 3.B, the unilateral CAP change resulted in a $50 cost reduction to the fixed price contract group ETC, $25 cost reduction to the flexibly priced contract group ETC, and additional costs of $75 on the non-CAS-covered contract group ETC. The increased cost to the Government, *in the aggregate*, would be $25 ($50 increased cost to the Government on fixed price less the $25 decreased cost to the Government on flexibly priced). The contractor would continue to bill the negotiated $100 fixed price contract amount ($50 additional profit) and would only bill the $75 incurred on the flexibly priced contract amount ($25 cost reduction). The Government is entitled to the additional $25 of profit on the fixed price contract group.

Scenario 3.C: No Change to Flexibly Priced Cost with Increased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 75	$ 100	$ (25)	$ 25	$ -	
Flexibly Priced - CAS-covered	100	100	-	-	-	
Non-CAS-covered	125	100	25	-	-	
Total	$ 300	$ 300	$ -	$ 25	$ -	***$ 25***

In scenario 3.C, the unilateral CAP change resulted in a $25 cost reduction to the fixed price contract group ETC, no change to the flexibly priced contract group ETC, and an additional $25 of costs on the non-CAS-covered contract group ETC. The increased cost to the Government, *in the aggregate,* would be $25. The contractor would continue to bill the negotiated $100 fixed price contract group amount resulting in $25 additional profit and is therefore increased cost to the Government. The Government is entitled to the additional $25 of profit on the fixed price contract group.

(4) Decreased Cost to the Government on both Flexibly Priced and Fixed Price: When the unilateral CAP change results in **decreased** cost to the Government on both the flexibly priced and fixed price CAS-covered contract/subcontract groups, there is no increased cost to the Government in the aggregate. The following illustration shows how the cost impact calculation may appear and is provided as an example.

Scenario 4: Decreased Flexibly Priced Cost and Decreased Fixed Price Cost

Contract Group	ETC After Change	ETC Before Change	Change in ETC	Increased Cost to the Gov't.	Decreased Cost to the Gov't.	***Increased Cost in the Aggregate***
Fixed Price - CAS-covered	$ 125	$ 100	$ 25	$ -	$ 25	
Flexibly Priced - CAS-covered	75	100	(25)	-	25	
Non-CAS-covered	100	100	-	-	-	
Total	$ 300	$ 300	$ -	$ -	$ 50	***$ -***

Questions and Further Information

FAO personnel with questions regarding this memorandum should contact their regional or CAD offices.

Regional/CAD personnel with questions regarding this memorandum should contact Policy Accounting and Cost Principles (PAC) Division for assistance via e-mail at dcaa.belvoir.hq.mbx.dcaa-pac@mail.mil.

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