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IN REPLY REFER TO

PAC 730.3.B.01/2005-05

June 6, 2005
05-PAC-041(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Revised FAR Part 30, Cost Accounting Standards Administration, and Related Contract Clause and Solicitation Provisions

SUMMARY

This memorandum provides audit guidance on the recent amendments to FAR Part 30, Cost Accounting Standards (CAS) Administration, and the related contract clause at FAR 52.230-6, Administration of Cost Accounting Standards, as well as the new solicitation provision added at FAR 52.230-7, Proposal Disclosure – Cost Accounting Practice Changes. The revised rule and contract clause and the new solicitation provision became effective April 8, 2005.

The significant revisions to FAR Part 30 pertain to the process for determining and resolving the cost impact on CAS-covered contracts and subcontracts when a contractor makes a change to a cost accounting practice or fails to comply with CAS. Substantive changes have also been made to FAR Part 30 by adding definitions of pertinent terms and delineating the processes for administering cost accounting changes and noncompliances. The revised FAR Part 30 provides the process of calculating and resolving cost impacts. The 5-step process for calculating cost impacts provided in the audit guidance issued in February 2000, and incorporated in CAM 8-503, reflects the concept of calculating cost impacts promulgated by this revision to FAR Part 30.

The language in FAR 52.230-6, the clause to be included in CAS-covered contracts, was revised to reflect the changes made to FAR Part 30. The new provision at FAR 52.230-7 is to be included in solicitations for contracts subject to CAS. It provides requirements for pricing a proposal when the contract award will result in a change to the contractor's cost accounting practice.

The revisions to FAR Parts 30 and 52 are provided as Enclosures to this memorandum.

GUIDANCE

Auditors should follow the revised FAR Part 30, which provides the rules that the cognizant Federal agency official (CFAO), cognizant auditor, and contractors are to follow in the administration of CAS requirements. The significant changes to FAR Part 30 are summarized below.

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- **FAR 30.001, Definitions:** This is a new section of FAR Part 30 that defines terms used throughout FAR Part 30 in the administration of CAS. FAR 30.001 also includes revised definitions for the classification of changes to cost accounting practices to match their definitions and terminology in CAS. Changes to cost accounting practices are now classified as (1) Required, (2) Unilateral, or (3) Desirable. These types of cost accounting practice changes are discussed in CAM 8-502.2.
- **FAR 30.202-7, Determinations:** The procedures in FAR 30.202-7 were clarified.

FAR 30.202-7(a) requires that:

- ✓ The auditor evaluate the contractor's Disclosure Statement for adequacy and report the results of that audit to the CFAO. Audit guidance on performing evaluations of Disclosure Statements is provided in CAM 8-200.
- ✓ The CFAO determine the adequacy of the contractor's Disclosure Statement and notify the contractor in writing of the adequacy or inadequacy, generally within 30 days after receiving the Disclosure Statement. The CFAO should provide a copy of the notification to the auditor.
- ✓ The CFAO request a revised Disclosure Statement, if the Disclosure Statement is inadequate.

FAR 30.202-7(b) requires that:

- ✓ The auditor, after receiving notification of the adequacy of the Disclosure Statement, conduct a compliance audit of the disclosed practices and advise the CFAO of the results of that audit. The auditor's responsibilities are also discussed in CAM 8-303.
 - ✓ The CFAO make a determination as to the compliance of the contractor's disclosed practices with the CAS standards.
 - ✓ The CFAO request a revised Disclosure Statement in all instances of noncompliance.
- **FAR 30.602, Materiality:** A new section was added at FAR 30.602 to guide the CFAO in determining whether cost accounting practice changes and noncompliances, as well as related cost impacts, are material.
 - ✓ FAR 30.602(a) directs the CFAO to use the materiality criteria at 48 CFR 9903.305 in making these determinations.
 - ✓ FAR 30.602(b) provides that the CFAO can make a determination of materiality either before or after a general dollar magnitude (GDM) proposal has been submitted, depending on the facts and circumstances of the cost accounting practice change or noncompliance.
 - ✓ FAR 30.602(c) provides that if the CFAO determines the cost impact is immaterial, the CFAO may conclude the cost impact process without making contract adjustments. However, in instances of noncompliance, the CFAO must inform the contractor that the noncompliance should be corrected and that the Government

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reserves the right to make appropriate contract adjustments should the cost impact become material in the future.

- ✓ FAR 30.602(d) provides that when the CFAO determines the cost impact is material, the CFAO should proceed with resolving the cost impact as provided in FAR 30.606.

The provisions in FAR 30.603, 604 and 605 are to be used to determine the cost impact if the CFAO does not make an initial determination of immateriality based on the nature of the change or noncompliance.

- **FAR 30.603-1, Required changes:** FAR 30.603-1 and the solicitation provision at FAR 52.230-7, Proposal Disclosure – Cost Accounting Practice Changes, identify the process contractors are required to follow when the award of a contract would require a change to an established cost accounting practice. The contractor must:
 - ✓ Disclose that the award of the subject contract would require that the contractor change an existing cost accounting practice(s),
 - ✓ Prepare the contract pricing proposal using the changed cost accounting practice(s), and
 - ✓ Submit a description of the changed cost accounting practice(s) with the proposal to the contracting officer and CFAO.

The CFAO must then make a determination as to whether each changed cost accounting practice is a required change.

The CFAO must process a required change that was implemented by a contractor prior to the applicability date as a unilateral change, unless the CFAO determines that the change is desirable. Thus, contractors implementing required changes before the applicability date may not receive an equitable adjustment unless the CFAO determines that the change is a desirable change.

- **FAR 30.603-2, Unilateral and desirable changes:** Unilateral and desirable changes are defined at 48 CFR 9903.201-6(b)(2) and (c)(2) and FAR 30.001.
 - ✓ A unilateral change is a change from one compliant cost accounting practice to another compliant practice made by the contractor that has not been determined by the CFAO to be a desirable change. 48 CFR 9903.201-6(b) provides that the Government *will not pay* increased costs in the aggregate resulting from unilateral changes.
 - ✓ A desirable change is a unilateral change made by the contractor that has been determined by the CFAO to be desirable and not detrimental to the Government and, therefore, not subject to prohibition of payment of increased costs. 48 CFR 9903.201-6(c) provides that the Government will negotiate an equitable adjustment of the cost impact resulting from desirable changes.

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FAR 30.603-2(a) provides that the Government may not pay increased costs in the aggregate as a result of a unilateral change.

FAR 30.603-2(b) provides that until and unless a change is determined by the CFAO to be desirable, it is considered to be unilateral. Examples of the criteria to be considered in making the determination include compliance with FAR Part 31, management actions anticipated to result in cost savings, and the availability of funds required in cases of upward price adjustment.

FAR 30.603-2(c) describes the contractor's requirements for advance notification to the Government of unilateral cost accounting practice changes. If the contractor implements a change without submitting the required notification, the CFAO may treat the implemented change as a failure to follow a cost accounting practice consistently and process it as a noncompliance.

FAR 30.603-2(d) provides that a contractor may request that a change to a cost accounting practice be retroactive, but it requires that the contractor submit rationale supporting such a request. The CFAO must make a determination on the request but, in any case, may not approve any change retroactive to before the beginning of the contractor's fiscal year in which the request is made.

FAR 30.603-2(e) incorporates the CAS regulation that provides that the contract price adjustment provisions do not apply to changes related to external restructuring activities.

- **FAR 30.604, Processing changes to disclosed or established cost accounting practices:** The requirements for processing changes to disclosed or established cost accounting practices are provided in FAR 30.604. It provides that the CFAO must:
 - ✓ With the assistance of the auditor, review the description of the change for adequacy and compliance and advise the contractor of the adequacy and compliance in writing (FAR 30.604(b)),
 - ✓ Evaluate the contractor's request that the change be determined to be desirable (FAR 30.604(c)), and
 - ✓ Request the contractor submit a general dollar magnitude (GDM) proposal, unless the CFAO determines by another means that the cost impact is immaterial (FAR 30.604(b)).

FAR 30.604(d) and (e) address the requirements for GDM proposals. FAR 30.604(g) provides requirements for detailed cost-impact (DCI) proposals. FAR 30.604(f) requires the evaluation of the GDM and FAR 30.604(h) provides the requirements for calculating cost impacts.

FAR 30.604(e) provides that the GDM:

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- ✓ Must calculate the cost impact in a manner reflected in the 5-step method delineated in FAR 30.604(h). This procedure is explained in CAM 8-503.
- ✓ May be based on a representative sample of affected contracts, the change in indirect rates applied to the estimated base for each contract type, or any other method that provides a reasonable approximation of the cost impact.
- ✓ May be in any form acceptable to the CFAO as long as it includes, at a minimum:
 1. The total increase or decrease in cost accumulations for each affected agency, including the impact on profit, fees and incentives, for each contract type; and
 2. The increased or decreased costs to the Government for each contract type.

FAR 30.604(f) provides that the GDM may be accepted as the basis for determination of a cost impact and adjustment of contract prices without the submission of a DCI, at the discretion of the CFAO. It provides that a DCI is required if the CFAO determines the GDM is not sufficient to resolve the cost impact.

FAR 30.604(g) provides that the DCI:

- ✓ Must calculate the cost impact in a manner reflected in the 5-step method delineated in FAR 30.604(h). This procedure is explained in CAM 8-503.
- ✓ Must show the impact on each affected CAS-covered contract and subcontract unless the CFAO agrees to require only the impact on those affected contracts and subcontracts exceeding a specified amount.
- ✓ May be in any form acceptable to the CFAO as long as it includes, at a minimum:
 1. The total increase or decrease in cost accumulations for each affected agency, including the impact on profit, fees and incentives, for each contract type (i.e., fixed-price contracts vs. flexibly priced contracts); and,
 2. The increased or decreased costs to the Government for each contract type.

FAR 30.604(i) provides that in the event the contractor fails to provide the descriptions of its cost accounting practice changes or cost impact proposals required by the CFAO, the CFAO shall:

- ✓ With the assistance of the auditor, estimate the GDM of the noncompliance and
 - ✓ Either withhold up to 10% of each future payment to the contractor up to the amount of the GDM until the contractor submits the required information, or
 - ✓ Issue a final decision and unilaterally adjust contracts to recover the GDM.
- **FAR 30.605, Processing noncompliances:** FAR 30.605(a) through (c) provide the requirements for processing noncompliances with CAS. These requirements ensure that the Government *will not pay* increased costs in the aggregate resulting from the noncompliance.

FAR 30.605(b) requires that the CFAO:

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- ✓ Determine for each reported instance of noncompliance whether the CFAO believes a potential noncompliance exists.
- ✓ Notify the contractor and auditor of that determination.
- ✓ Inform the contractor that immaterial noncompliances should be corrected and that the Government reserves the right to make contract adjustments if the noncompliance is not corrected and becomes material in the future.

FAR 30.605(d) through (h) reiterate the requirements for GDM and DCI proposals and the method for measuring and resolving cost impacts.

FAR 30.605(i) provides that if the contractor fails to correct the noncompliance or submit the required cost impact proposal, the CFAO shall:

- ✓ Estimate the GDM of the noncompliance with the assistance of the auditor, and
- ✓ Either withhold up to 10% of each future payment to the contractor up to the amount of the GDM until the contractor submits the required information, or
- ✓ Issue a final decision and unilaterally adjust contracts to recover the GDM.

As revised, FAR 30.604 and 30.605 provide guidance incorporated in the first 4 steps of the 5-step cost impact process that is currently described at CAM 8-503. These steps are equally applicable to both GDMs and DCIs and represent a consistent approach to determining increased costs to the Government in the aggregate regardless of the level of detail required by the CFAO.

- **FAR 30.606, Resolving cost impacts:** This section provides the requirements to be followed by the CFAO in resolving cost impacts.
 - ✓ FAR 30.606(a)(2) provides that a CFAO may resolve a cost impact by adjusting a single contract, several contracts, all contracts, or any other suitable method. This represents the last step of the 5-step method described in CAM 8-503.
 - ✓ FAR 30.606(a)(3) specifies which cost impacts can be combined and the conditions under which they can be combined.
 1. The following cost impacts shall not be combined:
 - A required change and a unilateral change.
 - A required change and a noncompliance.
 - A desirable change and a unilateral change.
 - A desirable change and a noncompliance.
 2. The following cost impacts shall not be combined *unless* all of the cost impacts are increased costs to the Government:
 - One or more unilateral changes.
 - One or more noncompliances.
 - Unilateral changes and noncompliances.

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- ✓ The CFAO may consider the cost impacts of a unilateral change affecting two or more segments to be a single change if the change affects the flow of costs between segments or it implements a common cost accounting practice for two or more segments.
- **FAR 30.607, Subcontract administration:** This section specifies that when a price adjustment or determination is made at the subcontract level, the CFAO for the subcontractor shall provide the negotiation memorandum or determination to the CFAO of the next higher-tier contractor who may not change the determination of the CFAO at the lower-tier subcontractor. In addition, the section provides that remedies are made at the prime contract level if a subcontractor refuses to submit a required GDM or DCI proposal.
- **FAR 52.230-6, Administration of Cost Accounting Standards:** The contract clause for CAS administration has been revised to incorporate the new FAR 30 rules for administering CAS rules, regulations, and standards. The revised clause at FAR 52.230-6 is to be included in CAS-covered contracts awarded after April 8, 2005.
- **FAR 52.230-7, Proposal Disclosure – Cost Accounting Practice Changes:** These new provisions must be included in solicitations for contracts subject to CAS issued after April 8, 2005. The provisions
 - ✓ Require that the contractor disclose whether the award of the subject contract will result in the contractor making either a required or unilateral change to its cost accounting practices, and
 - ✓ Instruct the contractor to:
 1. Prepare the proposal using the changed practice for the period of performance for which the changed practice will be used; and
 2. Submit a description of the changed cost accounting practice to the Contracting Officer and the CFAO as pricing support for the proposal.

CONCLUDING REMARKS

Auditors should apply the guidance in this memorandum immediately. Revisions to the cost impact audit program, audit report shell, and CAM to reflect this guidance are currently in process.

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If FAO personnel have any questions, they should contact regional personnel. If regional personnel have any questions, they should contact the Headquarters, Accounting and Cost Principles Division at (703) 767-3250.

/Signed/
Robert DiMucci
Assistant Director
Policy and Plans

Enclosures: 3

1. FAR Part 30, Cost Accounting Standards Administration, as revised
2. FAR Subpart 52.230-6, Administration of Cost Accounting Standards, as revised
3. FAR 52.230-7, Proposal Disclosure – Cost Accounting Practice Changes

Enclosure 1	Enclosure 2	Enclosure 3
 FAR 30 - Final Version (70 FR 11743)	 FAR Subpart 52.230-6 Revisions.do	 FAR Subpart 52.230-7.doc

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