

Ch 3 - Reviewing the Contractor's Pricing and Accounting Practices

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3.1 Reviewing Accounting Systems

Accounting System Importance. The accounting system is the source of most of the cost or pricing data and cost information other than cost or pricing data a firm provides to the Government. For that reason, you should be concerned about the firm's accounting system whenever you make any decisions involving the use of these data, such as:

- Contract pricing;
- Contractor responsibility, particularly for other than firm fixed-price contracts; or
- Initiation of progress payments.

Accounting System Review ([FAR 31.201-6](#) and DCAM 5-202.2). The objective of the accounting system review is to determine the adequacy and suitability of a firm's accounting system and practices for accumulating costs under a prospective or existing Government contract. There are three sources of accounting principles and standards which are applicable to contractor accounting systems. In order of precedence, these are:

- Cost Accounting Standards (CAS) promulgated by the Cost Accounting Standards Board. Whenever a contractor is required to comply with CAS, the requirements of those Standards take precedence over all other accounting guidance.
- Federal Acquisition Regulation (FAR). All contractors must comply with applicable FAR requirements. For example, FAR establishes basic guidelines regarding contractor accounting for unallowable costs.
- Generally Accepted Accounting Principles (GAAP). Accounting treatment not specifically covered by CAS or FAR requirements must be treated in accordance with

GAAP and the associated Financial Accounting Standards (FAS).

When contractor accounting practices are inconsistent with the applicable requirements, costs resulting from such inconsistent practices must not be allowed in excess of the amount that would have resulted using consistent practices.

Situations Requiring an Accounting System Review. You should contact the cognizant auditor any time that you suspect that the Government's interests may be at risk because of the contractor's accounting practices.

In particular, you should normally obtain an accounting system review as part of the following:

- Field pricing support;
- Preaward survey; or
- Review prior to initiation of progress payments.

Requesting Field Pricing Support ([FAR 15.404-2](#)). The contracting officer should request field pricing assistance when the information available at the buying activity is inadequate to determine a fair and reasonable price. When information is already available from an existing audit completed within the previous 12 months, never request a separate preaward audit of indirect costs unless the contracting officer considers the information inadequate for determining the reasonableness of the proposed indirect costs.

If you need a consolidated ACO/audit proposal analysis, request audit support through the ACO so the ACO can organize a coordinated review. If you only need an audit analysis, you may request the audit directly from the cognizant audit office using appropriate agency channels.

Agency procedures may provide additional guidance on when to request audit support. For example, DFARS directs DoD contracting officers to request field pricing support for:

- Fixed-price proposals exceeding \$500,000;
- Cost-reimbursement proposals exceeding \$500,000 from offerors with significant estimating system deficiencies; or

- Cost-reimbursement proposals exceeding \$10 million from offerors without significant estimating system deficiencies.

Field Pricing Support Information (DCAM 10-307 and 10-308). Auditors providing field pricing support should notify you if they believe that the offeror's accounting system is inadequate to support the proposal or to permit satisfactory administration of the contract contemplated. Audit manuals provide specific notification procedures. For example, the Defense Contract Audit Agency (DCAA) Contract Audit Manual (DCAM) encourages auditors to highlight accounting system deficiencies in three ways.

- The Scope of the Audit section of the audit report should identify the audit impact of any outstanding deficiencies.
- The Contractor's Organization and Systems section of the audit report should describe the contractor's accounting system including:
 - A brief description of the accounting system or reference to a prior audit report that provides a description. If the auditor references another report and that report has not been previously distributed to you, the auditor is encouraged to attach a copy of that report to the current report for your information.
 - An opinion on the overall system (adequate, inadequate, or inadequate in part).
 - An opinion on the control risk (low, moderate, or high) and the impact of the risk on the area being audited.
 - A list of outstanding internal control deficiencies including a brief description of each deficiency and the status of contractor corrective actions.
- Notes on any questioned costs should explain if the questioned cost is related to an accounting system deficiency.

Requesting Preaward Survey Information ([FAR 9.106](#)).

Normally, you should request a preaward survey when the information on hand or readily available is not sufficient to make a determination on contractor responsibility. However, unless you can justify the cost, you should not request a preaward survey for any:

- Commercial item acquisition or
- Fixed-price contract action at or below the simplified acquisition threshold.

As part of the preaward survey request, you may request an accounting system review. Simply indicate the need for a review on the [Standard Form \(SF\) 1403 \(PDF file\)](#), Preaward Survey of Prospective Contractor.

Preaward Survey Information ([FAR 9.106-4](#) and 53.301-1408). The person responding to the request, normally the cognizant auditor, will complete a [Standard Form \(SF\) 1408 \(PDF file\)](#), Preaward Survey of Prospective Contractor Accounting System. That person will make a general recommendation on the adequacy of the contractor's accounting system. As a minimum, the reviewer should also answer the following questions in making the recommendation:

- Is the accounting system in accord with generally accepted accounting principles that are applicable to the contractor?
- Does the accounting system provide for:
 - Proper segregation of direct costs and indirect costs?
 - Identification and accumulation of direct costs by contract?
 - A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives?
 - Accumulation of costs under general ledger control?
 - A time keeping system that identifies employee's labor by intermediate and final cost objectives?
 - A labor distribution system that charges direct and indirect labor to the appropriate cost objectives?
 - Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account?
 - Exclusion from costs charged to Government contracts of amounts which are not allowable under FAR Part 31 and other contract clauses?
 - Identification of costs by contract line item and by units if required by the contract?
 - Segregation of preproduction costs from production costs?

- Does the accounting system provide financial information:
 - Required by contract clauses concerning limitation of cost and limitation of payments?
 - Required to support progress payments?
- Is the accounting system designed and are the records maintained in such a manner that adequate, reliable data are developed for use in pricing follow-on acquisitions?
- Is the accounting system currently in full operation?

Requesting a Review Prior to Initiation of Progress Payments ([FAR 32.503-3](#) and [32.503-4](#)). An adequate accounting system is essential for effective administration of progress payments. Progress payments in the amounts requested should be approved as a matter of course when the ACO has found from previous experience or recent (within the last 12 months) audit review that a contractor is:

- Reliable, competent, and capable of satisfactory performance,
- Possessed of an adequate accounting system and controls, and
- In sound financial condition.

For all other contractors, the ACO must not approve progress payments before determining that the:

- Contractor will be capable of liquidating any progress payments, or the Government is otherwise protected against loss by additional protective clauses, and
- Contractor's accounting system and controls are adequate for proper administration of progress payments.

The ACO should use the services of the cognizant Government auditor to the greatest extent practicable in making these determinations. However a complete audit may not be necessary.

Information from A Review Prior to Initiation of Progress Payments (DCAM 14-202.1f).

Audit report comments on the accounting system will generally be brief unless controls are found to be unacceptable. A standard comment might read: "The audit disclosed no weaknesses in the contractor's internal

control procedures that would necessitate a restriction of contract financing through progress payments." If controls are found to be unacceptable, the report should detail specific weaknesses.

Preparing an Initial Position on Adequacy ([FAR 30.202-7](#)). A contractor has only one cost accounting system. There should never be a situation where one contracting officer determines that the system is adequate while another contracting officer determines that the system is not adequate.

When one is assigned, the ACO should play the key role in determining accounting system acceptability. Under CAS, the ACO is responsible for determining the adequacy of the contractor's Disclosure Statement and for any action needed to require contractor correction of noncompliant accounting practices.

Before taking any action related to the adequacy of the contractor's accounting system, review the available information and ask any questions necessary to assure that you understand the position taken by the auditor, the ACO (if one is assigned), and any other experts involved in reviewing the accounting system. Consider the following:

- Facts found during the accounting system review.
- Missing or insufficiently documented findings.
- Apparent fallacies (quantitative or logical).
- Inconsistencies between the findings and other available information.

Based on the available information, establish an initial judgment on the adequacy of the system as the basis for discussions with the contractor. That position will depend on the reason for the review.

- If the system review was part of a proposal analysis, your position may be that the proposal is not adequate for negotiation.
- If the review was part of a preaward survey, your position may be that the contractor is not responsible or that the accounting system is not acceptable for the proposed contract type (e.g., cost-reimbursement).
- If the review involved progress payments, your position may be that the system is not adequate to support progress payments.

As most audit reports will caution you, audit results should not be used for purposes other than the purpose for which the audit was accomplished without consulting the auditor.

Discussing the Accounting System Review ([FAR 15.303\(c\)](#), [15.404-2\(a\)\(5\)](#), and [15.404-2\(c\)\(1\)](#)).

In general, the results should not be discussed with anyone not directly involved in the contracting process. The contracting officer is responsible for determining who should have information from the accounting system review (ASR) and how much data should be provided. If the ASR uncovers weaknesses or deficiencies, consider discussing them with the contractor prior to making a decision on adequacy.

In conducting discussions with the contractor, consider the following guidelines:

- The contracting officer should control all discussions.
- Other personnel such as the cognizant auditor should be invited to support the contracting officer as required, including participation in discussions.
- During discussions, the contractor should be advised of specific accounting system weaknesses or deficiencies.
- The contractor should be given an opportunity to provide additional information and take other action necessary to correct any possible misunderstandings.
- If further contractor action is required to resolve weaknesses or deficiencies, specific areas of action should be identified and a corrective action plan established. Any plan proposed by the contractor should include target completion dates for identified action. Request comments from the cognizant auditor on any proposed corrective action plan.

Findings on System Adequacy ([FAR 15.404-2\(c\)\(4\)](#) and [FAR 15.404-2\(d\)](#)). You may find an accounting system to be:

- Adequate.
- Adequate with exceptions covered by a corrective action plan.
- Inadequate.

In making the decision on system adequacy, you should place heavy reliance on the recommendation of the cognizant auditor and the ACO if one is assigned. Remember, auditors are the accounting experts who have general access to the contractor's accounting records, and the ACO is responsible for overall contract administration. To facilitate up to date audit support assure that the cognizant auditor receives a copy of any additional information presented by the contractor that may significantly affect audit findings. You may request the auditor to immediately review the disclosed information and report orally on the findings, followed by a supplemental report when necessary.

If you take any position on system adequacy other than the position recommended by the auditor, clearly document the rationale that led you to that position.

Protecting the Government's Interests ([FAR 9.104-1\(e\)](#), [15.403-1](#), [15.404-1\(b\)](#), and [32.503-3\(b\)](#)).

If you find that the contractor's accounting system is not adequate, you must take appropriate action to protect the Government's interests. The action that you take should depend on the situation.

- If you requested the review as part of Government field pricing support, you may have rely exclusively on available price information to determine price reasonableness.
- If you requested a preaward survey to determine if the firm's accounting system is adequate to support award and administration of a cost-reimbursement contract, you may decide to:
 - Eliminate the firm from consideration as nonresponsible¹ or
 - Consider withholding award until the contractor agrees to remedy any identified deficiencies.
- If you requested a review prior to initiating progress payments based on cost, you may refuse to make progress payments based on cost until the accounting system is made acceptable. If the Government is already making progress payments based on cost, you should reduce or suspend progress payments until the accounting system is made acceptable. As an alternative to progress payments based on cost, you may consider performance-based payments.

¹ Before rejecting a small business offer that you consider to be nonresponsible, refer the matter to the Small Business Administration, which will decide whether or not to issue a Certificate of Competency.

3.2 Establishing The Government's Position On CAS Cost Impact Adjustments

CAS Coverage ([FAR App B, 9904](#)). When a contract is CAS-covered, the Standards take precedence over all other forms of accounting guidance. The table below, divides the 19 current Standards into four groups to highlight the types of coverage involved.

COST ACCOUNTING STANDARDS	
Concepts and Principles	
CAS 401	Consistency in Estimating, Accumulating, and Reporting Costs
CAS 402	Consistency in Allocating Costs Incurred for the Same Purpose
CAS 405	Accounting for Unallowables
CAS 406	Cost Accounting Period
Allocation of Costs to Contracts	
CAS 403	Allocation of Home Office Expense
CAS 407	Use of Standard Cost Systems
CAS 410	Allocation of Business Unit G&A
CAS 418	Allocation of Direct and Indirect Costs
Identification & Assignment of Costs	
CAS 404	Capitalization of Tangible Assets
CAS 409	Depreciation of Tangible Assets
CAS 408	Accounting for Paid Absence
CAS 412	Composition & Measurement of Pension Costs
CAS 413	Adjustment & Allocation of Pension Costs
CAS 415	Accounting for Deferred Compensation
CAS 416	Accounting for Insurance Costs
CAS 411	Accounting for Acquisition Costs of Materials
CAS 420	Accounting for IR&D/B&P
Cost of Money	
CAS 414	Cost of Money as an Element of Facilities Capital

CAS 417	Cost of Money of Capital Assets under Construction

CAS Exemptions ([FAR 30.201-4\(a\)](#) and [App B, 9903.201-1](#)). All contracts awarded using sealed bidding are exempt from CAS coverage. When awarding a contract using negotiation procedures, insert CAS clauses unless the contract or offeror is specifically exempt from CAS requirements.

A contract or subcontract that is not CAS-covered at the time of award cannot become CAS-covered as the result of a contract or subcontract modification.

Criteria for Exempting Negotiated Contracts or Subcontracts From CAS Coverage	
Basis For Exemption	Exempt If Any Of The Following Situations Exist
Dollar Amount of Contract Award	The contract or subcontract price is less than or equal to \$500,000 at the time of award. (When determining CAS exemptions, treat an order issued by one segment of a corporation to another as a subcontract.)
Small Business	The contract or subcontract is with a small business.
Commercial Item(s)	The firm fixed-price or fixed-price economic price adjustment (provided that price adjustment is not based on actual costs incurred) contract or subcontract is for a commercial item(s).
Method of Pricing	The contract or subcontract price is set by law or regulation.
	The contract or subcontract is firm fixed-price and awarded without contractor submission of any cost data.
Foreign Contractor/ Performance	The contract or subcontract is with a United Kingdom contractor for performance substantially in the United Kingdom (provided that the contractor has filed with the United Kingdom Ministry of Defense, for retention by the ministry, a completed disclosure statement which adequately describes its cost accounting practices).

	Whenever the contractor or subcontractor is already required to follow U.K. Government Accounting Conventions, the disclosed practices must be in accord with those Conventions.
	The contract or subcontract is with a foreign government, agent, or instrumentality, or for the requirements of CAS 401 and 402, any contract or subcontract awarded to a foreign concern.
	The contract or subcontract will be executed and performed entirely outside the United States, its territories, and possessions.
	The subcontract under the NATO PHM Ship program will be performed outside the United States by a foreign concern.

Types of CAS Coverage ([FAR App B, 9903.2](#)). The two major types of CAS coverage for commercial contracts are outlined in the table below. Note that offerors with a smaller dollar value of CAS-covered may elect application of the less stringent modified coverage. However, if an offeror that qualifies for modified coverage does not specifically elect modified coverage, the firm will be subject to the requirements of full coverage.

CAS Coverage		
Coverage Type	Application	Coverage requires that the business unit...
Full	<p>Applies to contractor business units that...</p> <ul style="list-style-type: none"> • Receive a single CAS-covered contract award of \$25 million or more; or • Received \$25 million or more in net CAS-covered awards during its preceding cost accounting period, of which, at least one award exceeded \$1 	<p>Comply with all Standards that are in effect on the date of contract award and with any Standards that become applicable because of later award of a CAS-covered contract.</p> <p>In addition, the business unit must submit and maintain</p>

	million.	a Disclosure Statement of its accounting practices.
Modified	<p>If the offeror certifies that it is eligible for and elects to use modified coverage, it may be applied to a CAS-covered contract of:</p> <ul style="list-style-type: none"> • Less than \$25 million awarded to a business unit that received less than \$25 million in net CAS-covered awards in the immediately preceding cost accounting period; or • Business units that received more than \$25 million in net CAS covered awards in the immediately preceding cost accounting period, wherein no single contract award exceeded \$1 million. 	<p>Comply with CAS 401, 402, 405, and 406.</p> <p>Note: A contract awarded with modified CAS coverage shall remain subject to modified coverage throughout its life regardless of changes in the business unit's CAS status during subsequent cost accounting periods.</p>

Disclosure Statement ([FAR App B, 9903.202-1](#) and [App B, 9903.202-9](#)). A Disclosure Statement is a written description of a contractor's cost accounting practices and procedures. The Statement is normally submitted using a Disclosure Statement Form (CASB DS-1), and requires the contractor to provide general information on its accounting system and specific information on how the firm accounts for specific types of costs.

Requirement for a Disclosure Statement ([FAR App B, 9903.202-1](#)). When a Disclosure Statement is required, a separate Disclosure Statement must be submitted for each segment with costs exceeding \$500,000 in the total price of any CAS-covered contract or subcontract, unless:

- The contract or subcontract is of the type or value exempted from CAS requirements, or
- CAS-covered awards in the most recently completed cost accounting period are less than 30 percent of total segment sales for the period and less than \$10 million.

Each corporate or other home office that allocates costs to one or more disclosing segments performing CAS-covered contracts must submit a completed Part VIII of the Disclosure Statement.

Foreign contractors and subcontractors who are required to submit a Disclosure Statement may, in lieu of filing a CASB-DS-1, make disclosure by using a disclosure form prescribed by an agency of its Government, provided that the Cost Accounting Standards Board determines that the information disclosed by that means will satisfy the objectives of Public Law 100-679. Currently, the use of alternative forms has been approved for the contractors of Canada and the Federal Republic of Germany.

Disclosure Statement Adequacy Review ([FAR 30.202-7\(a\)](#)).

The cognizant auditor must review the Disclosure Statement to ascertain whether it is current, accurate, and complete and report the results of that review to the contracting officer. Based on the audit findings, the ACO must determine if it adequately discloses the firm's accounting practices. If the ACO determines that the Disclosure Statement is:

- Adequate, the ACO must notify the offeror in writing with copies to the cognizant auditor and affected contracting officers. The notice must state that a disclosed practice shall not, by virtue of its disclosure, be considered an approved practice for pricing proposals or accumulating and reporting contract performance cost data.
- Not adequate, the ACO must request a revised disclosure statement.

Disclosure Statement Adequacy and Contract Award ([FAR 30.202-6\(b\)](#)). Normally, the contracting officer for a proposed contract must not award a CAS-covered contract until the ACO has made a written determination that a required Disclosure Statement is adequate. However, in order to protect the Government's interest, the contracting

officer may waive the requirement for an adequacy determination before contract award. If such a waiver is granted, the contracting officer must require a determination of adequacy as soon as possible after contract award.

Disclosure Statement Changes and Equitable Adjustments. Changes in the contractor's disclosed accounting practices may be required for a variety of reasons during CAS coverage. The table below identifies several types of accounting changes and situations when an equitable adjustment is required.

Requirements for Equitable Adjustment Under CAS Coverage		
Type of Accounting Change	Description	An equitable adjustment is required..
Noncompliance FAR 30.602-2	The change is required to eliminate contractor noncompliance with previously established CAS requirements.	Only if the net result is a reduction in the cost to the Government for CAS-covered contracts. Do not allow an increase in the cost to the Government for CAS-covered contracts.
Required FAR 30.602-1(a)(2)	Required to comply with a new or modified Standard issued by the CAS Board	Upward or downward (as appropriate). The ACO must negotiate an equitable adjustment on existing CAS-covered contracts.
Voluntary - Desirable FAR 30.602-3(a)(2)	The change is voluntary, but the ACO determines that the change is desirable and not detrimental to the Government.	Upward or downward (as appropriate). Since the change is desirable for the Government, an equitable adjustment should be negotiated.
Voluntary - Other FAR 30.602-3(a)(2)	The change is voluntary and the ACO does not determine that the change is desirable for the Government.	Only if the net result is a reduction in the cost to the Government for CAS-covered contracts. Since the change is voluntary and not considered desirable, the ACO must not allow a

		net increase in the cost to the Government for CAS-covered contracts.
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Equitable Adjustment for Noncompliance ([FAR 30.202-7](#) and [30.602-2](#)). After the ACO's notification of Disclosure Statement adequacy, the cognizant auditor must conduct a detailed compliance review to ascertain whether or not the disclosed practices comply with [FAR Part 31](#) and CAS. Contractor failure to comply with CAS may be identified then or at any time during CAS coverage. The cognizant auditor must report any alleged noncompliance to the ACO for appropriate action.

Under the contract Cost Accounting Standards clause, the contractor must agree to an adjustment in contract price or a cost allowance, if the contractor fails to comply with an applicable Standard or to follow any cost accounting practice consistently and such failure results in increased cost to the Government. Adjustments must provide for recovery of increased costs and related interest computed at the annual rate established under Section 6621 of the Internal Revenue Code of 1986.

The following table outlines the general steps involved in negotiating the cost impact of CAS noncompliance.

Negotiating the Cost Impact of CAS Noncompliance	
Step	ACO Action
1	Within 15 days of receipt of a report of alleged noncompliance from the auditor, make an initial finding of compliance or noncompliance and notify the auditor.
2	If you make an initial finding of noncompliance, immediately notify the contractor in writing of the exact nature of the noncompliance and allow the contractor 60 days within which to agree or to submit reasons why the existing practices are considered to be in compliance.
3	If the contractor disagrees with the initial finding of noncompliance, review the reasons why the contractor considers the current practices to be in compliance and make a determination of compliance or noncompliance, including a written

	<p>explanation on the rationale used in making the decision. Notify the contractor and the auditor in writing of the determination.</p>
4	<p>When a proposed change is submitted, review it for adequacy and compliance. If the description of the change meets both tests, notify the contractor and request submission of a cost impact proposal.</p> <ul style="list-style-type: none"> • For each flexibly-priced contract, the cost impact of the change on the Government will depend on the difference between projected actual cost to the Government before the change and projected cost to the Government after the change. • For firm fixed-price contracts the net amount due the Government: • Increases when contract cost estimates under the proposed practice decrease from the cost estimates that were used to price the contract. • Decreases when contract cost estimates under the proposed practice increase from the cost estimates that were used to price the contract.
5	<p>Analyze the cost impact proposal and develop a negotiation position on any net decrease due the Government considering input from the cognizant auditor and other available information. Separately identify any interest due on any costs paid to the contractor as a result of the noncompliance.</p>
6	<p>Negotiate an appropriate decrease in the cost of existing CAS-covered contracts. If an agreement cannot be negotiated, you may make a unilateral adjustment, subject to contractor appeal as provided for in the contract Disputes clause.</p>
7	<p>After negotiation, execute appropriate supplemental agreements for CAS-covered contracts of the ACO's own agency and send copies of the negotiation memorandum to the:</p> <ul style="list-style-type: none"> • Contracting officers for contracts from other agencies with affected prime contracts. Those contracting officers are required to issue their own supplemental agreements in the amount negotiated.

	<ul style="list-style-type: none"> • ACOs of any next higher-tier subcontractor or prime contractor with a subcontract requiring adjustment. The memorandum shall be the basis for negotiation between the subcontractor and the next higher-tier subcontractor or prime contractor
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Required Accounting System Change ([FAR 30.602-1](#), [52.230-1](#), and [52.230-2](#)). The solicitation Cost Accounting Standards Notices and Certification provision, requires offerors to state whether or not the award of a proposed contract would require a change to established cost accounting practices that would affect existing contracts and subcontracts.

A new or modified Standard becomes applicable prospectively to existing CAS-covered contracts when a new contract containing the Cost Accounting Standards clause is awarded on or after the effective date of the new or modified Standard. If the new contract award does require an accounting system change to comply with a new or modified Standard, that change may affect the costs charged to other contracts. Contracts and subcontracts containing the Cost Accounting Standards clause may require equitable adjustments. Adjustments are limited to open contracts and subcontracts awarded before the effective date of the new or modified Standard.

The general process for negotiating the cost impact of an accounting system change required to comply with a new or modified Standard is presented in the following table.

Negotiating the Cost Impact of a Required Change	
Step	ACO Action
1	Require contractor submission of the following information on any required change in cost accounting practices within 60 days (or other mutually agreed to date) after award of the contract requiring the change: <ul style="list-style-type: none"> • A description of the change; • Total potential cost impact of the change on CAS-covered contracts; • Potential shift of costs between CAS-covered

	<p>contracts by contract type; and</p> <ul style="list-style-type: none"> • Potential impact on funds of the various agencies/departments.
2	<p>With assistance from the cognizant auditor, review the proposed change for adequacy and compliance. If the description of the change meets both tests, notify the contractor and request submission of a cost impact proposal.</p> <ul style="list-style-type: none"> • For each flexibly-priced contract, the cost impact of the change on the Government will depend on the difference between projected actual cost to the Government before the change and projected cost to the Government after the change. • For firm fixed-price contracts the net amount due the Government: <ul style="list-style-type: none"> • Increases when the contract costs decrease from what they would have been without the change. • Decreases when the contract costs increase from what they would have been without the change.
3	<p>Analyze the cost impact proposal and develop a negotiation position on the net cost impact of the change (increases and decreases) on all CAS-covered contracts and subcontracts (considering input from the cognizant auditor and other available information).</p>
4	<p>Negotiate either a net increase or decrease to the existing CAS-covered contracts. If an agreement cannot be negotiated, you may make a unilateral adjustment, subject to contractor appeal under the contract Disputes clause.</p>
5	<p>After negotiation, execute appropriate supplemental agreements for CAS-covered contracts of your own agency and send copies of the negotiation memorandum to the:</p> <ul style="list-style-type: none"> • Contracting officers for contracts from other agencies with affected prime contracts. Those contracting officers are required to issue their own supplemental agreements in the amount negotiated.

	<ul style="list-style-type: none"> • ACOs of any next higher-tier subcontractor or prime contractor with a subcontract requiring adjustment. The memorandum shall be the basis for negotiation between the subcontractor and the next higher-tier subcontractor or prime contractor
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Voluntary Accounting System Change ([FAR 30.602-3](#), [52.230-6](#), and DCAM 8-503.2). The Administration of Cost Accounting Standards clause of CAS-covered contracts requires the contractor to notify the ACO and submit a description of any voluntary cost accounting practice change not less than 60 days (or such date as mutually agreed to) before implementation of the voluntary change.

Negotiating the Cost Impact of a Voluntary Change	
Step	ACO Action
1	<p>If the you become aware of a proposed voluntary change, you may remind the contractor that the contract requires the firm to submit the following information on any voluntary change in cost accounting practices not less than 60 days (or other mutually agreed to date) before implementation:</p> <ul style="list-style-type: none"> • A description of the change; • Total potential cost impact of the change on CAS-covered contracts; • Potential shift of costs between CAS-covered contracts by contract type; and • Potential impact on funds of the various agencies/departments.
2	<p>With assistance from the cognizant auditor, review the proposed change for adequacy and compliance. If the description of the change meets both tests, notify the contractor and request submission of a cost impact proposal.</p> <ul style="list-style-type: none"> • For each flexibly-priced contract, the cost impact of the change on the Government will depend on the difference between projected actual cost to the Government before the change and projected cost to the Government after the

	<p>change.</p> <ul style="list-style-type: none"> • For firm fixed-price contracts the net amount due the Government: • Increases when the contract costs decrease from what they would have been without the change. • Decreases when the contract costs increase from what they would have been without the change.
3	<p>Analyze the cost impact proposal and develop a negotiation position on the net cost impact of the change (increases and decreases) on all CAS-covered contracts and subcontracts (considering input from the cognizant auditor and other available information).</p> <ul style="list-style-type: none"> • If the change is desirable and not detrimental, you may negotiate a net cost decrease or increase. • If the change is not considered desirable, you may negotiate a net cost decrease but must not negotiate a net cost increase.
4	<p>Negotiate an appropriate change to the cost of existing CAS-covered contracts. If an agreement cannot be negotiated, you may make a unilateral adjustment, subject to contractor appeal under the contract Disputes clause.</p>
5	<p>After negotiation, execute appropriate supplemental agreements for CAS-covered contracts of your own agency and send copies of the negotiation memorandum to the:</p> <ul style="list-style-type: none"> • Contracting officers for contracts from other agencies with affected prime contracts. Those contracting officers are required to issue their own supplemental agreements in the amount negotiated. • ACOs of any next higher-tier subcontractor or prime contractor with a subcontract requiring adjustment. The memorandum shall be the basis for negotiation between the subcontractor and the next higher-tier subcontractor or prime contractor

Alternatives for Contract Price Adjustments ([DCAM 8-503.5](#)). When adjusting the price of CAS-covered contracts because of accounting system changes:

- Contracts may be adjusted individually or cost increases and decreases of more than one contract may be offset to reduce the number of contract adjustments.
- Cost increases in one organizational segment of a company may be offset by decreases in another segment if the change causes costs to flow between segments either directly or via a higher organizational level (e.g., a home office).
- Within a segment, the effect of several changes may be combined in the offset consideration if the changes all take place at the same time.
- When a mix of contract types is involved, grouping by type, by materiality, or other method of segregation may often reduce the complexity of the problem and also reduce the number of price adjustments that must be made.

Remedies for Contractor Failure to Make Submissions ([FAR 30.602-1\(d\)](#), [30.602-2\(d\)](#), and [30.602-3\(d\)](#)).

If the contractor fails to submit the required description of the general dollar magnitude of the change or a required cost impact proposal (in the form and manner specified), the ACO, with assistance from the cognizant auditor, must take appropriate action as outlined in the following table:

Response To Contractor Failure To Make Submissions	
Step	ACO Action
1	Estimate (with assistance from the cognizant auditor) the general dollar magnitude of the change or proposed change on all CAS-covered contracts and subcontracts affected.
2	If the estimate indicates that there is a net amount due the Government, you may withhold up to 10 percent of each payment due the contractor on CAS-covered contracts.
3	If the contractor has not made the required submission before the total estimated amount is withheld and you determine that an adjustment is appropriate, you must:

	<ul style="list-style-type: none"> • Request the contractor to agree to a cost or price adjustment based on the estimate. • Advise the contractor that, in the event agreement on a cost or price adjustment is not reached within 20 days, you may make a unilateral adjustment subject to contractor appeal under the contract Disputes clause.
4	If the contractor fails to agree with the cost or price adjustment or make the required submission, you should make a unilateral price adjustment (unless you deem another course of action more appropriate).

3.3 Reviewing Cost Estimating Systems

Estimating System Importance ([FAR 15.407-5\(a\)](#), [DFARS 215.407-5-70](#), and [252.215-7002](#)).

Verifiable, supportable, and well-documented cost estimates benefit both the Government and the contractor. The key to consistent preparation of quality estimates is an adequate estimating system.

An estimating system encompasses the contractor's policies, procedures, and practices for generating cost estimates and other data included in proposals submitted to customers in the expectation of receiving contract awards. Components include the contractor's:

- Organizational structure;
- Established lines of authority, duties, and responsibilities;
- Internal controls and managerial reviews;
- Flow of work, coordination, and communication; and
- Estimating methods, techniques, accumulation of historical costs, and other analyses used to generate cost estimates.

Conditions That May Indicate Estimating Deficiencies ([DFARS 215.407-5-70\(d\)\(3\)](#)). Significant estimating deficiencies are often the result of poorly constructed estimating systems. A good system integrates all aspects of the contractor's operation into an effective and trackable information flow. Some of the areas that may be included

are: cost accounting, production management, budgeting, subcontracting/purchasing, inventory control, and strategic business planning.

The following have been identified by the DoD as conditions that may indicate potentially significant estimating deficiencies and excessive costs to the Government:

- Failure to ensure that historical data on the same or similar work are available to and utilized by cost estimators where appropriate.
- Continuing failure to analyze material costs or failure to perform subcontractor cost reviews as required.
- Consistent absence of analytical support for significant proposed costs.
- Excessive reliance on individual personal judgment where historical experience or commonly used standards are available.
- Recurring significant defective pricing findings within the same cost element(s).
- Failure to integrate relevant parts of other management systems (e.g., production or cost accounting) with the estimating system so that the ability to generate reliable cost estimates is impaired.
- Failure to provide established policies, procedures, and practices to persons responsible for preparing and supporting estimates.

Other indicators of problems include:

- Management information that does not match the data in proposals.
- Standards for labor and material costs that are not current.
- Changes in make-or-buy decisions not disclosed.
- Inappropriate or misleading sampling techniques.

Review Situations ([FAR 15.407-5](#)). The concepts of Total Quality Management (TQM) teach that good systems are more likely to produce good products. Based on this philosophy, the Government uses three types of reviews to assure that the estimating systems used to produce contract cost proposals are adequate.

- **Ongoing Audit Review Programs.** Cognizant auditors may establish and manage regular programs for reviewing selected contractor's estimating systems or methods in order to:
 - Reduce the scope of reviews to be performed on individual proposals;
 - Expedite the negotiations process; and
 - Increase the reliability of proposals.

The auditor sends a copy of the estimating system survey report and a copy of the official notice of corrective action required to each contracting office and contract administration office having substantial business with that contractor. Significant deficiencies not corrected by the contractor must be considered in subsequent proposal analyses and negotiations.

- **Contractually Mandated Estimating System Review** ([FAR 15.404-2\(d\)](#), [DFARS 215.407-5-70](#), and [252.215-7002](#)).
- An agency may authorize or require contracting officers to establish and monitor a contractually mandated program of periodic estimating system reviews. For example, ACOs assigned to the DoD must establish a contractually mandated review program for any contractor that meets the following requirements:
 - During its preceding fiscal year, the contractor received DoD prime contracts or subcontracts totaling \$50 million or more for which certified cost or pricing data were required.
 - During its preceding fiscal year, the contractor received DoD prime contracts or subcontracts totaling \$10 million or more, but less than \$50 million, for which certified cost or pricing data were required, and the contracting officer with the concurrence of the ACO determines that a review is in the best interest of the Government.
- **Field Pricing Support.** Auditors requested to provide field pricing support may identify estimating system deficiencies while performing any required audit. They should notify you if they believe that the offeror's estimating methods are inadequate to support the proposal or permit satisfactory administration of the contract contemplated.

Conducting a Review. When evaluating the acceptability of contractor's estimating system, the cognizant auditor

should consider any factors that affect estimate development such as the following:

- The source of data for estimates and the procedures for ensuring the data are accurate, complete, and current;
- The documentation developed and maintained in support of the estimate;
- The assignment of responsibilities for originating, reviewing, and approving estimates;
- The procedures followed for developing estimates for direct and indirect cost elements;
- The extent of coordination and communication between organizational elements responsible for the estimate; and
- Management support, including estimate approval, establishment of controls, and training programs.

Resolving Deficiencies ([FAR 15.407-5](#)). Whenever an estimating system review is conducted, the auditor will document the findings and recommendations and provide them to the contracting officer (the ACO when one is assigned).

Significant deficiencies not corrected by the contractor must be considered in subsequent proposal analysis and negotiations.

The contractually-mandated DoD estimating system review program described above includes detailed guidelines for resolving deficiencies in the adequacy of contractor disclosure or estimating system characteristics.

Resolving Deficiencies in Contractually Mandated Estimating Systems	
Step	ACO Action
1	The contract Cost Estimating System Requirements clause requires the contractor to establish and maintain an adequate estimating system and disclose that system to the ACO in writing.
2	The cognizant auditor will head a team review of the contractor's estimating system disclosure and report findings on the adequacy of the disclosure and the system.
3	Provide a copy of the team report to the contractor and ask the contractor to submit a written response to any identified deficiencies within 30 days, or a

	<p>reasonable extension thereof.</p> <ul style="list-style-type: none"> • If the contractor agrees with the report, the contractor has 60 days from the date of initial notification to correct deficiencies or submit a corrective action plan showing milestones and actions to eliminate the deficiencies. • If the contractor disagrees, the contractor should provide rationale in its written response.
4	<p>In consultation with the cognizant auditor, evaluate the contractor's response to determine whether:</p> <ul style="list-style-type: none"> • The existing system contains deficiencies which need correction. • The deficiencies are significant deficiencies that should result in disapproval of all or a portion of the contractor's estimating system. • The contractor's proposed corrective actions are adequate to eliminate the deficiency.
5	<p>Notify the contractor and the auditor of the Step 4 determination and, if appropriate, of the Government's intent to disapprove all or selected portions of the system. The notice must:</p> <ul style="list-style-type: none"> • List the cost elements covered. • Identify any deficiencies requiring correction. • Require the contractor to correct the deficiencies within 45 days or submit an action plan showing milestones and actions to eliminate the deficiencies.
6	<p>If the contractor has neither submitted an acceptable corrective action plan nor corrected significant deficiencies within 45 days, disapprove all or selected portions of the contractor's estimating system. The disapproval must:</p> <ul style="list-style-type: none"> • Identify the estimating system elements covered. • List the deficiencies which prompted the

	<p>disapproval.</p> <ul style="list-style-type: none"> • Be sent to the cognizant auditor, and each contracting and contract administration office having substantial business with the contractor.
7	<p>With the auditor, monitor the contractor's progress in correcting deficiencies. If the contractor fails to make adequate progress, take whatever action is necessary to ensure that the contractor corrects the deficiencies. Examples of the action that you can take include:</p> <ul style="list-style-type: none"> • Bringing the issue to the attention of higher-level management. • Reducing or suspending progress payments. • Recommending that potential contracts not be awarded to the contractor.
8	<p>Withdraw the estimating system disapproval when you determine that the contractor has corrected the significant system deficiencies. Notify the contractor, the auditor, and affected contracting and contract administration activities of the withdrawal.</p>

Protect the Government's Interests ([FAR 15.407-5\(b\)](#) and [DFARS 215.407-5-70\(g\)\(2\)](#)). If you are responsible for negotiation of a proposal generated by an estimating system with an identified deficiency, you must determine whether the identified deficiency impacts your negotiations. If it does not, proceed with negotiations as usual. If it does, you must take appropriate action to protect the Government's interests. The table below identifies some of the actions that you should consider:

For contractor estimating systems with identified deficiencies --	
Consider the following alternatives...	And the following factors related to each alternative...
Allow additional time for proposal	If the contractor can correct the estimating system deficiencies affecting the proposal in a reasonable amount of

preparation/ revision.	time, this option may be appropriate.
Consider changing the contract type.	Changing contract type (e.g., from FFP to FPIF) may reduce the risk to the Government. However all factors that lead to contract type selection should be considered. That may require reaccomplishing some elements of acquisition planning.
Perform additional cost analysis on suspected cost areas.	To protect the Government's interests and dig deeper into the suspected problem area, additional analysis may be appropriate. However, this does not excuse the contractor from making the necessary estimating system improvements.
Segregate suspected cost elements in a cost- reimbursement line item.	While this may work in some cases, there are several potential problems, including possible Cost Accounting Standards violation, an additional monthly billing, delays in contract closeout since the reimbursable item will require final closeout rates.
Reduce the fee/profit objective.	Proposal preparation can be considered in formulating a fee/profit objective. However, reduced fee/profit is not a substitute for possibly allowing unreasonable or unallowable costs.
Insert a reopener clause covering the suspected cost elements.	A reopener for an estimating system deficiency should identify the dollars in question and the impact on total price. (However, reopener clauses must be carefully employed and properly administered.) The clause must clearly identify the contracting officer responsible for negotiating any adjustments required by the clause. For example, in the DoD, the reopener clause must be administered by the person or office that incorporated the clause in the contract.

Monitoring Corrective Action ([DFARS 215.407-5-70\(f\)\(6\)](#)).
The cognizant auditor and administrative contracting officer are responsible for monitoring contractor progress in correcting deficiencies administrative. Should the

contractor fail to make adequate progress in correcting deficiencies, several options are available:

- Highlight the deficiencies in audit and pricing reports.
- Elevate the matter to higher level contract management
- Consider reducing or suspending progress payments until identified deficiencies are corrected.
- Recommend that contracting officers not award contracts until identified deficiencies are corrected.

3.4 Recognizing Potential Indicators Of Fraud And Other Wrongdoing

Evidence of Fraud or Other Wrongdoing (DCAM 4-702.1b). When reviewing a firm's pricing and accounting practices, you may encounter information constituting evidence or causing suspicion of fraud or other wrongdoing. Sources of such information may include file documentation, statements from company employees or disgruntled participants in the wrongdoing, or other sources. Allegations may be made by letter, telephone, personal visit, or through a third party.

For the purpose of this section, the term "fraud and other wrongdoing" means any willful or conscious wrongdoing, including, but not limited to, acts of cheating or dishonesty which cause (or contribute to) a loss or injury to the Government. Examples include:

- Falsification of documents such as time cards or purchase orders;
- Charging personal expenses to Government contracts;
- Submitting false claims such as invoices for services not performed or materials not delivered;
- Intentional mischarging or misallocation of costs;
- Deceit by suppression of the truth;
- Bribery;
- Payments that violate the Foreign Corrupt Practices Act;
- Theft;
- A Government employee acquiring a financial interest in or seeking employment with a contractor over whom the employee exercises oversight;
- Kickbacks;

- Unlawful or fraudulent acts resulting from accounting classification practices designed to conceal the true nature of expenses (e.g., classifying unallowable advertising or entertainment costs as office supplies);
- Product substitution or false certification that tests were performed; or
- Any attempt or conspiracy to engage in, or use, any of the above devices.

Potential Fraud Related to Defective Pricing.

Contracting personnel must be particularly alert to potential incidents of contractor fraud related to defective pricing—incidents where the contractor **knowingly makes a false statement or a false claim** with the intent of defrauding the Government. The Department of Defense Inspector General (DODIG) has identified 29 indicators and scenarios of potential fraud related to defective pricing:

- Alteration (without notice to the Government) or falsification of supporting data;
- Failure to update cost or pricing data even though it is known that past activity showed that costs or prices have decreased;
- Failure to make complete disclosure of data known to responsible contractor personnel;
- Distortion of the overhead accounts or baseline information by transferring charges or accounts that have a material impact on Government contracts;
- Failure to correct in a timely manner, known estimating or pricing system deficiencies which directly and repeatedly result in defective pricing;
- Repeated denial by the responsible contractor employees of the existence of historical records that are subsequently found;
- Proposing one vendor, while intending, at the time of that proposal, to use another lower priced vendor;
- Intentional failure to update cost or pricing data when clearly required by law or regulation;
- Selectively disclosing work orders with higher costs while knowingly not including additional pertinent work orders with lower costs;
- Altering the dates on material or subcontract purchase orders from dates prior to the prime contract negotiations to dates after the negotiations;

- Repeated instances of lost or destroyed records (other than those destroyed pursuant to the contractor's normal document destruction policy) which would provide supporting details for proposed costs that were based on experience;
- Fabrication of supporting information for a proposed cost factor when no historical information is actually collected or segregated for that type of expense;
- An undisclosed change in a make-versus-buy decision which is known by the contractor prior to the conclusion of final price negotiations;
- Not disclosing total company material requirements for items qualifying for quantity/sale discounts, thereby knowingly proposing a higher unit price than the combined purchase will actually generate;
- Claiming an exemption from the submittal of cost or pricing data based on catalog or market pricing when the company knows the end user of the item is always the Government;
- Proposing an increase in price due to a break in production when the contractor knows, based on the proposed delivery schedule, that no break will occur;
- Protracted delay in the release of data to the Government to which the Government is clearly entitled, under the law and regulations existing at the time of the initial request for the data, for the purpose of avoiding a reduction in negotiated price;
- Including rates in the proposal, such as insurance or workman's compensation, which are deliberately increased or inflated above the contractor's actual forecasted rates;
- Intentionally duplicating costs by proposing them as both direct and indirect;
- Consciously proposing items the contractor knows, or should know, are obsolete or unneeded to perform the contract;
- Not disclosing inventory that the contractor knew, should have known, or suspected was excess and available for use on later contracts;
- Deliberately not disclosing known or company-available actual costs that were reasonably available prior to the conclusion of price negotiations for a follow-on contract;
- Proposing a purchase at price (subcontract or interorganizational transfer) for a portion of the contract effort when the contractor knows, at the time

- of proposing, the effort will be performed via an interorganizational transfer at cost;
- Willful, knowing, or reckless disregard of the contractor's established estimating practices;
 - Suppressing internal/external studies or reports that do not support the proposed costs;
 - Commingling work orders with other work orders to hide productivity improvements or deliberately distorting the labor-hours incurred for a particular series of work orders;
 - Requesting an economic price adjustment clause for material that has already been purchased;
 - Submitting false documents; or
 - Intentionally failing to disclose internal documents on vendor discounts that constitute cost or pricing data and were reasonably available prior to the conclusion of price negotiations.

Persons and Situations Involved (DCAM 4-702.1a).

Allegations of fraud or other wrongdoing may involve the acts of:

- Government employees (military or civilian) in their relations with the Government.
- Government employees (military or civilian) in their relations with individuals or firms.
- Individuals or firms in their business relations with the Government.
- Individuals or firms in their business relations with other individuals or firms doing business with the Government.

Responsibility to Report (Executive Order 12674, as amended, [DOD 5500.7-R](#), and [FAR 1.602-2](#)).

Government officials receive guidance on ethical conduct from a combination of laws, executive orders, regulations, and directives. While specific procedure may vary from agency to agency, this guidance consistently emphasizes that employees must report any suspected waste, fraud, abuse, or corruption to appropriate authority.

Contracting personnel have a special responsibility to safeguard the interests of the United States in its contractual relationships. That includes a responsibility to ensure that all ethics guidelines are strictly followed throughout the contracting process.

Coordinated Team Effort ([FAR 3.700](#)). The Government may pursue different remedies for fraud or other suspected types of wrongdoing. In many cases, the action will involve civil or criminal court action. Administrative actions may also be involved. For example, the Government has the right to void or rescind a contract when the contractor is found guilty of bribery, conflict of interest, or similar misconduct related to the contract.

A coordinated Government Acquisition Team effort is essential to assure effective resolution given the merits of the case. The Government legal counsel should play a key role in determining the proper course of action. For cases related to pricing and accounting practices, the cognizant Government auditor should be involved in establishing the merits of the case.