



DEPARTMENT OF DEFENSE
Defense Contract Management Agency

INSTRUCTION

Final Overhead Rates

Contracts Directorate
OPR: DCMA-AQ

DCMA-INST 125
April 21, 2014

1. PURPOSE. This Instruction:

- a. Updates and reissues DCMA Instruction (DCMA-INST 125), “Final Overhead Rates” (Reference (a)).
- b. Is established in accordance with the authority in DoD Directive 5105.64, “Defense Contract Management Agency (DCMA)” (Reference (b)).
- c. Implements Department policy pursuant to listed references.
- d. Establishes policies and assigns responsibility for ensuring that administrative contracting officers (ACO) obtain certified final indirect cost rate proposals and appropriately settle final indirect rates. This guidance also outlines procedures for ACO assessment of penalties and interest related to expressly unallowable costs contained in a final indirect rate proposal.

2. APPLICABILITY. This Instruction applies to all DCMA activities unless higher-level regulations, policy, guidance, or agreements take precedence.

3. MANAGERS’ INTERNAL CONTROL PROGRAM. This Instruction contains internal management control provisions that are subject to evaluation and testing as required by DCMA-INST 710, “Managers’ Internal Control Program” (Reference (c)). The process flowchart is located on the policy resource Web page (resource page) for this Instruction.

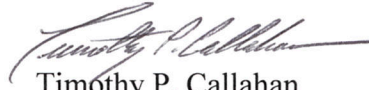
4. RELEASABILITY – UNLIMITED. This Instruction is approved for public release.

5. PLAS CODE(S).

- a. Process: 044 – Final Overhead Rates.
- b. Programs: ACAT/Other Customers (when applicable).
- c. Other National; Training and Travel; Local Programs (when applicable).

6. POLICY RESOURCE PAGE. <https://home.dcm.mil/policy/125r>

7. EFFECTIVE DATE. By order of the Director, DCMA, this Instruction is effective April 21, 2014, and all applicable activities shall be fully compliant within 60 days from this date.



Timothy P. Callahan
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SUMMARY OF CHANGES

This Instruction has been rewritten and should be read in its entirety. The following identifies the most notable updates.

- More detailed guidance for ACOs issuing unilateral final indirect rates when a contractor has not provided a proposal or has been delinquent in correcting an inadequate proposal. This includes adapting into the policy a new DCAA HQ and DCMA HQ coordination plan for identifying late and/or inadequate final indirect rate proposals.
- Guidance is provided for when an ACO must establish final indirect rates where a contractor's accounting records have been lost or destroyed.
- Guidance is provided for when an ACO must establish final indirect rates where a contractor is out of business and DCAA has no audit history for the contractor.
- Additional guidance is provided for when ACOs encounter an audit report that is qualified relative to pending assist audits.
- Guidance is provided about additional information to be included in a price negotiation memorandum (PNM).
- Additional guidance about preparing a PNOM and PNM when ACO is able to engage in a post-COFD negotiated settlement.
- Expanded guidance is provided regarding cost allowability matters, ACO settlement of questioned direct costs, and penalty assessment matters.

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REFERENCES

- (a) DCMA-INST 125, "Final Overhead Rates," April 12, 2013 (hereby superseded)
- (b) DoD Directive 5105.64, "Defense Contract Management Agency (DCMA)," January 13, 2013
- (c) DCMA-INST 710, "Manager' Internal Control Program," September 12, 2011
- (d) Federal Acquisition Regulation
- (e) DCMA-INST 128, "Disallowance of Costs," December 4, 2013
- (f) DCMA-INST 120, "Pricing and Negotiation," April 1, 2014
- (g) DCMA-INST 126, "Contract Audit Follow-Up (CAFU)," August 22, 2013
- (h) DCMA-INST 809, "Records Management," May 1, 2011
- (i) DCMA-INST 552, "Information Security Program," October 29, 2013
- (j) DCMA-INST 134, "Boards of Review," October 15, 2012
- (k) Defense Contract Audit Agency Memorandum (14-PPD-002(R)), "Treatment of Delinquent Final Indirect Rate Proposals," February 3, 2014
- (l) Office of the Under Secretary of Defense Memorandum, "Class Deviation – DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals," July 24, 2012
- (m) DCMA Memorandum #13-288, "DCMA Quick-Closeout Class Deviation," September 18, 2013
- (n) DCMA, "Contract Closeout Guidebook," December 2013
- (o) DCMA, "Quick-Closeout Desktop Procedure," October 18, 2011
- (p) DCMA-INST 906, "Reporting Fraud, Waste and Abuse," October 1, 2010
- (q) DCMA-INST 905, "Contract Claims and Disputes," December 17, 2013
- (r) DFARS 242.803(b)(i), "Disallowing costs after incurrence"
- (s) DCAA Contract Audit Manual, section 5-111.1, July 30, 2013

CHAPTER 1

POLICY

1.1. POLICY.

1.1.1. The administrative contracting officer (ACO) shall ensure that contractors submit timely certified final indirect cost rate proposals as required by a contract and Federal Acquisition Regulation (FAR) (Reference (d)). The term ACO as used in this Instruction can also refer to a corporate administrative contracting officer (CACO) or a divisional administrative contracting officer (DACO).

1.1.2. If a certified final indirect rate proposal is late or inadequate, the ACO shall, with Defense Contract Audit Agency (DCAA)/or other audit (DCAA/A) assistance, seek to obtain an adequate final indirect cost rate proposal from the contractor. The acronym DCAA/A as used in this Instruction can refer to DCAA auditors, host nation auditors, or any other authorized auditor providing auditor type advisory service to the ACO.

1.1.3. The ACO, in conjunction with DCAA, shall determine whether proposed rates are subject to determination by the ACO or DCAA.

1.1.4. The ACO shall request, obtain, and utilize audit or a non-audit service from DCAA/A for all final indirect cost rate proposals. After receipt of a DCAA/A evaluation, the ACO shall properly document full consideration of all DCAA/A findings.

1.1.5. When DCAA utilizes a DCAA Form 1, Notice of Contract Costs Suspended and/or Disapproved, to report disallowed direct or indirect costs after incurrence, the ACO shall follow applicable guidance found in DCMA-INST 128, "Disallowance of Costs" (Reference (e)) relative to processing a DCAA Form 1. Disallowance of cost matters reported by host nation auditors is likewise covered in DCMA-INST 128 (Reference (e)).

1.1.6. When DCAA reports questioned direct costs in a DCAA Form 1, or in a DCAA/A audit report covering a final indirect rate proposal, the ACO shall identify and coordinate with the appropriate ACO or Procuring Contracting Officer (PCO) who has cognizance over the affected contract to help ensure that the cognizant ACO or PCO resolves direct costs questioned by DCAA/A.

1.1.7. The ACO shall request, obtain, and utilize input from other DCMA specialists as needed. After receipt of input from these specialists, the ACO shall properly document full consideration of all recommendations from consulted specialists.

1.1.8. When the ACO is responsible for final indirect rate determination, the ACO shall properly develop and document:

1.1.8.1. An evaluation of all findings by DCAA/A and DCMA specialists.

1.1.8.2. A record of interaction with other interested contracting offices.

1.1.8.3. Prenegotiation objectives memorandum (PNOM), in accordance with DCMA-INST 120, "Pricing and Negotiation – Contracts" (Reference (f)), unless rates are settled based on a DCAA adequacy review memorandum(s) (ARM).

1.1.8.4. Final rate agreements.

1.1.8.5. A price negotiation memorandum (PNM), in accordance with DCMA-INST 120 (Reference (f)), unless rates are settled based on a DCAA ARM.

1.1.9. The ACO shall properly distribute all appropriate documents to the contractor and to DCAA/A after negotiating a final indirect rate agreement.

1.1.10. The ACO shall make every effort to complete overhead negotiations within 27 months from the contractor's fiscal year-end (FYE) for major contractors and 36 months from the contractor's FYE for non-major contractors.

1.1.11. The ACO shall properly monitor receipt of DCAA/A audit reports and rate recommendations to ensure that questioned costs are resolved in a timely manner in accordance with FAR 33.206 (Reference (d)).

1.1.12. The ACO shall follow procedures for resolving or dispositioning reportable audits as prescribed in DCMA-INST 126, "Contract Audit Follow-Up (CAFU)" (Reference (g)).

1.1.13. The ACO shall properly assess penalty types, and interest due, on expressly unallowable costs claimed in a final indirect rate proposal.

1.1.14. The ACO shall retain documents associated with final indirect rate settlements as well as applicable penalty and interest assessments. All such document retention must conform to DCMA-INST 809, "Records Management" (Reference (h)) and conform with any additional guidance provided to the ACO by the component Commander/Director or a supervisor. Additionally, all documents associated with final indirect rate settlements must be appropriately marked in accordance with DCMA-INST 552, "Information Security Program" (Reference (i)). The most commonly required marking is "For Official Use Only" when a document contains proprietary information belonging to a contractor.

1.1.15. The ACO shall properly track final indirect settlement matters in the DCMA Overhead Negotiations eTool. (The eTool tracking is typically initiated by the DCAA Data Management Information System into the Overhead Negotiations eTool. The ACO must track progress (in the eTool) from the point of receipt of the initial proposal through final indirect rate settlement closing.)

CHAPTER 2

RESPONSIBILITIES

2.1. COMPONENT COMMANDER/DIRECTOR, REGIONAL COMMANDER/DIRECTOR, OR CONTRACT MANAGEMENT OFFICE (CMO) COMMANDER/DIRECTOR. The appropriate Commander/Director shall ensure compliance with this Instruction by subordinate contracting staff.

2.2. CMO CONTRACTS DIRECTOR, DIRECTOR OF CORPORATE/DIVISIONAL ADMINISTRATIVE CONTRACTING OFFICER (CACO/DACO) GROUP, OR SUPERVISOR FROM THE DACO GROUP WITHIN THE SPECIAL PROGRAMS DIRECTORATE. The appropriate Director or Supervisor shall:

2.2.1. Ensure compliance with this Instruction by subordinate contracting staff.

2.2.2. Provide written review/concurrence or non-concurrence when an ACO intends to grant a contractor an extension to a due date for an indirect cost rate proposal.

2.2.3. Provide written review/concurrence when an ACO intends not to accept a DCAA/A unilateral rate recommendation.

2.2.4. Ensure ACOs properly seek resolution of disagreements with DCAA/A auditors in conformity with DCMA-INST 134, "Boards of Review (BoR)" (Reference (j)). However, no BoR is required regarding the adequacy of host nation standard audit practices.

2.2.5. Provide review comments/concurrence by signature of an ACO's PNOM; or, may delegate management-level review of a PNOM to a level no lower than the contract team supervisor/leader.

2.2.6. Verify that ACOs follow the procedures for resolving or dispositioning reportable audits as prescribed in DCMA-INST 126 (Reference (g)), before reviewing a PNOM or PNM.

2.2.7. Provide review comments/concurrence by signature of an ACO's rate agreement and PNM prior to ACO signature, or, may delegate management-level review of these actions to a level no lower than the contract team supervisor/leader.

2.2.8. Establish and maintain internal controls to ensure the accuracy of ACO records in the Overhead Negotiations eTool.

2.3. ADMINISTRATIVE CONTRACTING OFFICERS (ACO). An ACO shall be responsible for fully complying with all applicable guidance in this Instruction.

2.3.1. The DACO is the principal ACO for developing and negotiating quick-closeout rates where a CACO/DACO/ACO network exists.

CHAPTER 3 PROCEDURES

3.1. OBTAIN ADEQUATE AND TIMELY CERTIFIED FINAL INDIRECT RATE PROPOSALS. The ACO shall ensure the contractor submits the required certified final indirect cost rate proposal within 6 months following the completion of a contractor's fiscal year as required by FAR 52.216-7(d)(2)(i) (Reference (d)). This requirement applies to all fiscal years that cover the contractual period of performance for any contract containing FAR clause 52.216-7(d)(2)(i) (Reference (d)).

3.1.1. The ACO shall only grant contractors due date extensions if the contractor submits a written request for an extension based on exceptional circumstances as explained in FAR 52.216-7(d)(2)(i) (Reference (d)).

3.1.2. ACOs shall obtain the appropriate Director's written review/concurrence or non-concurrence, and notify DCAA/A, prior to granting or denying the contractor an extension to the proposal due date.

3.1.2.1. If the ACO grants a time extension it must be provided to the contractor in writing as governed by FAR 42.705-1(b)(1)(ii) and FAR 52.216-7(d)(2)(i) (Reference (d)). Likewise, if the ACO denies the requested time extension, a denial shall be provided to the contractor in writing.

3.1.2.2. If the ACO grants or denies a time extension, the ACO shall prepare a written memorandum for record (MFR) to document the circumstances and the rationale for approving or denying the extension. The ACO shall provide DCAA/A a copy of the MFR.

3.1.3. If DCAA/A notifies the ACO that the contractor's certified final indirect cost rate proposal is late or inadequate, the ACO shall take steps to obtain an adequate proposal from the contractor.

3.1.3.1. One method by which an ACO may be notified of a late or inadequate final indirect rate proposal is through a coordinated effort between DCAA Headquarters (HQ) and DCMA HQ (DCAA Memorandum, (Reference (k))). This coordinated effort will involve DCAA HQ providing a listing of final indirect rate proposals that are overdue without a valid ACO extension or the final indirect rate proposals have been received but DCAA considers them inadequate. These DCAA provided listings (projected for annual release) will be disseminated to the field through the issuance of a published DCMA Memorandum.

3.1.3.2. DCAA has adopted the practice to send only one notice to a contractor regarding an overdue final indirect rate proposal. This notice will be sent to the contractor when a final indirect rate proposal is overdue by 30 days. A copy of the notice is to be provided to the ACO (Reference (k)).

3.1.3.3. The ACO shall immediately follow-up the DCAA 30-day overdue notice with a letter to the contractor explaining that the contractor must, within 30 business days of the date of the ACO's notification letter, notify the ACO of whether the contractor will request a time extension or the contractor will provide an adequate certified final indirect rate proposal to both the ACO and the cognizant DCAA auditors.

3.1.3.4. If the contractor does not reply to the ACO's first notification letter covered in paragraph 3.1.3.3., then the ACO shall send out a second notification letter instructing the contractor that an adequate certified final indirect rate proposal must be provided within 30 business days of the date of the second notification letter. Further, the ACO's second notification letter shall inform the contractor that if an adequate certified final indirect rate proposal is not provided within the noted 30 business days, then the ACO will proceed to unilaterally establish final indirect rates in accordance with FAR 42.703-2 (c) (Reference (d)).

3.1.3.5. As covered in subsequent paragraph 3.1.4.1., an ACO may interact with a contractor over a 6-month period after a final indirect rate proposal is due. In such instances, the more likely problem the ACO will encounter is that the contractor provides several final indirect rate proposals but DCAA deems them to be inadequate versus the contractor not providing a final indirect rate proposal. Accordingly, when a contractor is unresponsive (i.e., does not provide a final indirect rate proposal), then the ACO shall show less leniency (rather than allowing a 6-month grace period) and more promptly follow guidance found in paragraph 3.1.4.2.

3.1.4. The ACO shall take reasonable efforts to obtain an adequate final indirect cost rate proposal (see FAR 52.216-7(d)(2)(iii) (Reference (d)) for adequate proposal criteria). In some instances, a contractor may be non-cooperative or unable to provide support (e.g., financial records are lost or the contractor is no longer in business). After reasonable efforts have been made, the ACO shall take responsive actions that include options discussed below.

3.1.4.1. For purposes of this policy, "reasonable efforts" to obtain an adequate final indirect rate proposal means: both DCAA/A auditors and the ACO have sent several notifications to a contractor (over a 6-month period after a final indirect rate proposal is due) but are unable to obtain an adequate final indirect rate proposal. Consider the following "reasonable efforts" scenario. Assume Contractor XYZ, Inc. has a FYE of 12-31-2013 but by 06-30-2014 the contractor has not supplied a final indirect rate proposal or the contractor has not supplied an adequate final indirect rate proposal to the ACO. From 07-01-2014 through 12-31-2014 both the DCAA/A auditors and the ACO have communicated to the contractor that an adequate final indirect proposal is still due and/or have communicated what schedules or documentation are needed to correct the most recent deficient proposal that has been received. However, by 12-31-2014, Contractor XYZ, Inc. has not supplied a final indirect rate proposal for FYE 12-31-2013; or, Contractor XYZ, Inc. has not provided adequate schedules or documentation that were identified as deficient by DCAA/A and/or the ACO in prior communications. By 12-31-2014 "reasonable efforts" will have been exhausted and the ACO shall proceed to the guidance found at paragraph 3.1.4.2.

3.1.4.2. In conjunction with the requirements of FAR 42.703-2 (c) (Reference (d)), if a contractor has not provided an adequate and certified final indirect rate proposal, and a waiver has not been granted pursuant to FAR 42.703-2(b) (Reference (d)), then the ACO shall unilaterally establish final indirect rates using the guidance found in subsequent paragraph 3.1.6.

3.1.4.3. If a contractor has submitted a final indirect rate proposal but the contractor's records have been lost or destroyed, the ACO shall instruct the contractor to obtain copies of third party records and/or other forms of corroborating evidence to help demonstrate that the costs reported in a final indirect rate proposal are reasonable, allowable, and allocable per FAR Part 31 (Reference (d)) guidelines. As needed, the ACO shall request the assistance of auditors and technical specialists to help review the evidence the contractor supplies. The ACO has final authority to decide when/if the contractor has supplied sufficient evidence to support the costs/rates submitted in a final indirect rate proposal. The ACO also has the authority to disallow costs through cost adjustments where the ACO believes that the provided evidence does not support certain costs claimed in the final indirect rate proposal.

3.1.4.4. Cases may arise where a contractor is no longer in business and DCAA/A cannot perform an audit of a final indirect rate proposal. Additionally, DCAA/A may have no audit experience with the contractor relative to proposed costs/rates or incurred costs/rates that have been submitted by the contractor in the past. In such cases, the ACO shall take the following steps to establish final indirect rates.

3.1.4.4.1. The ACO must make a reasonable effort (see explanation of "reasonable efforts" and the applicable time period found at paragraph 3.1.4.1.) to obtain contractor support of a DCAA/A audit of any final indirect rate proposal that needs to be audited.

3.1.4.4.2. If the contractor cannot be reached or will not respond, the ACO shall unilaterally establish final indirect rates. The ACO must consider several factors relative to establishing final indirect rates.

3.1.4.4.2.1. The ACO shall contact the applicable PCO and contracting officer's representative (COR) to determine if the contractor has completed contract performance on all contracts covered in a final indirect rate proposal. Additionally, the ACO shall request the PCO and COR to provide information about whether the contractor is still in possession of Government property.

3.1.4.4.2.2. The ACO shall contact the Defense Finance and Accounting Services (DFAS) to determine if any money remains on contracts for a contractor to bill against. Additionally, the ACO must inquire of DFAS about amounts billed on contracts so a comparison can be made between the amounts billed by the contractor and the amounts reported by the contractor in all applicable final indirect rate proposals. The goal is to determine whether the contractor has been overpaid or underpaid relative to billed costs and costs reported as incurred.

3.1.4.4.2.3. The ACO shall determine if the contractor has filed for bankruptcy. If the contractor has filed for bankruptcy, the ACO must consider the possible need to set

unilateral rates lower than proposed (i.e., low enough to cover unallowable costs) and the risks to the Government in collecting money owed from a contractor in bankruptcy.

3.1.4.4.2.4. The ACO must consider all risks (using the information gathered under the steps covered in paragraphs 3.1.4.2.2.1. through 3.1.4.2.2.3.) to the Government, as well as seek advice from legal counsel, when unilaterally establishing final indirect rates.

3.1.5. The ACO may disallow claimed costs reported in late or inadequate proposals (i.e., statements of cost that are not adequately supported per FAR 31.201-2(d) and FAR 52.216-7(g)(1) (Reference (d))). Costs eligible for disallowance may include (one or more of the following):

3.1.5.1. Costs identified by DCAA/A issuance of Forms 1 or advisory memorandum (see paragraph 3.9.).

3.1.5.2. Using a decrement factor to apply to costs or accounts (within an inadequate proposal) that were identified as unallowable in recent DCAA/A incurred cost audit reports.

3.1.5.3. All costs/accounts (currently under audit) for which the contractor will not provide adequate supporting documentation to DCAA/A or the ACO.

3.1.5.4. Sensitive cost items (based on expense account name identified by DCAA/A) in an inadequate proposal. The ACO may then question all costs in those sensitive accounts until the contractor provides proof of allowability. See FAR 31.201-2(d) (Reference (d)). Only expense items that are allowable per the FAR Part 31 (Reference (d)) cost principles and Defense Federal Acquisition Regulation Supplement (DFARS) provisions, and adequately supported, shall be deemed allowable. All other unsupported costs in a sensitive account shall be deemed unallowable. This approach may be useful when DCAA/A has no prior audit experience with a contractor.

3.1.6. The ACO may establish unilateral rates (FAR 42.703-2(c), Reference (d)) by:

3.1.6.1. Requesting DCAA/A to provide a position for the ACO to consider in setting unilateral rates.

3.1.6.2. Reviewing historical information (e.g., history of proposed costs compared to negotiated costs) to determine the appropriateness of DCAA/A's recommended unilateral rates. If DCAA/A does not provide timely support, the ACO may obtain assistance from a DCMA Cost/Price Analyst or otherwise develop unilateral rates.

3.1.6.3. Setting rates low enough to ensure that unallowable costs will not be reimbursed (based on information in paragraphs 3.1.6.1. and 3.1.6.2.).

3.1.7. After obtaining appropriate management review of the ACO developed unilateral rates, the ACO shall proceed to issue a unilateral rate determination letter as covered in paragraph 3.7.2.4. of this Instruction.

3.2. OBTAIN A DEFENSE CONTRACT AUDIT AGENCY OR OTHER AUDITOR (DCAA/A) AUDIT.

3.2.1. The ACO shall request and receive a DCAA/A audit of the contractor's certified final indirect cost rate proposal. Deviations from requiring DCAA/A audits are covered in paragraphs 3.3. and 3.5.

3.2.2. For international CMOs supported by a local Host Contract Administration Services Audit Authority, applicable international agreements determine the specific role of the contract auditor. Thus, host nation auditors may be required instead of DCAA auditors.

3.2.3. When an ACO requests an audit of a final indirect rate proposal, the ACO must be aware that the subsequent audit report (supplied by DCAA/A) may report on matters relating both to direct contract costs and indirect costs. Paragraphs 3.9.3. through 3.9.5.4. of this Instruction contains guidance regarding ACO settlement of questioned direct costs.

3.2.4. When an ACO receives an audit report that is qualified because the results of an assist audit are still pending, the ACO must consider the nature and impact of the costs that are affected by the qualified opinion.

3.2.4.1. In some instances, the qualified audit opinion (due to another pending assist audit report) may relate to subcontract costs that are a type of other direct costs. Subcontract costs typically have no impact relative to settling a prime contractor's final indirect rates. However, the assist audit (covering subcontract costs) will likely be needed to settle specific contract costs with the prime contractor.

3.2.4.2. Some qualified audit opinions may relate to pending audits associated with inter-company cost allocations: from a home office; from an intermediate home office; or from a shared services group. The ACO may need to settle or establish final indirect rates without waiting for the results of pending audits of inter-company cost allocations. Such cases are described below.

3.2.4.2.1. An ACO may decide not to wait for audit results when the ACO determines that the applicable inter-company cost allocations will have no material impact on the rates to be negotiated or established by the ACO.

3.2.4.2.2. An ACO may decide not to wait for audit results when the ACO determines that regulatory time limits (such as covered by FAR 4.804-1(a)(3) and/or FAR 33.206 (Reference (d)) will not allow for additional time to wait for the results of a pending audit.

3.3. ACCEPT A DCAA PROPOSAL ADEQUACY REVIEW IN LIEU OF AUDIT OR WAIVE AN AUDIT, AS APPROPRIATE. The ACO shall accept final proposed indirect rates based solely on a DCAA proposal adequacy review or may waive an audit based on the following conditions:

3.3.1. The ACO is not aware of any factors or circumstances that place a given final indirect rate proposal at risk for containing expressly unallowable costs as covered by FAR 42.709 (Reference (d)). Some sources for the ACO to identify potential costs risks are:

3.3.1.1. DCMA contract files.

3.3.1.2. Other DCAA audits.

3.3.1.3. Input from technical specialists.

3.3.1.4. Input from PCOs.

3.3.1.5. Input from subcontractors.

3.3.2. The ACO receives a memorandum from DCAA explaining that:

3.3.2.1. The auditor's adequacy review did not disclose any significant audit leads.

3.3.2.2. The auditor's adequacy review included a mathematical verification and a determination that the contractor's proposal was certified by its top management officials that the proposal does not include unallowable costs.

3.3.2.3. The auditor's overall assessment of risk placed the contractor's incurred cost proposal in a low-risk sampling pool.

3.3.2.4. Based on the factors identified in paragraphs 3.3.2.1. through 3.3.2.3., the proposal was not selected for audit.

3.3.3. If the conditions identified in above paragraphs 3.3.1. and 3.3.2. exist, a Defense Procurement and Acquisition Policy (DPAP) Class Deviation (Reference (1)) permits an ACO to utilize a DCAA ARM in lieu of an audit. Typically, DCAA obtains a signed rate agreement from the contractor and attaches it to the ARM. If no rate agreement is attached to the ARM, the ACO shall proceed to settle rates with the contractor without the need for a PNOM or PNM. If DCAA does not obtain a signed rate agreement from the contractor, the ACO shall negotiate a rate agreement using the DCAA ARM to settle final indirect rates for that fiscal year by accepting the proposed rates. (A template for a rate settlement agreement document can be found at a link on the resource page associated with this Instruction.) The ACO shall promptly distribute executed copies of the rate agreement to each affected contracting office and DCAA. The ACO shall document in the contract file both the date and method of transmittal of the rate agreement documents to DCAA. The DCAA ARM, the signed rate agreement document, and

the description of the method of transmittal document satisfy/complete the ACO's required documentation for the files in cases where the ACO must negotiate the final indirect rates based on a DCAA ARM. ACOs shall document completion of the rate settlement in the Overhead Negotiations eTool as stipulated in subsequent paragraph 3.14.1.

3.3.4. In selected instances, there is a DCMA Quick-Closeout Class Deviation (Reference (m)) that permits the ACO to waive an audit requirement when compelling reasons exist. The decision to waive the audit must be made by the cognizant ACO in consultation with DCAA.

3.4. IDENTIFY IF RATES ARE ACO- OR DCAA-DETERMINED. The ACO shall follow the procedures stipulated in FAR 42.705-1 and FAR 42.705-2 (Reference (d)) to determine whether the rates are subject to determination by the ACO or DCAA.

3.5. APPLY QUICK-CLOSEOUT PROCEDURES AS NEEDED.

3.5.1. There may be instances where the ACO should negotiate the settlement of indirect costs, in advance of the determination of final indirect cost rates, for a specific contract or group of contracts. This process, known as "Quick-Closeout Procedure," is governed by FAR 42.708 (Reference (d)). However, where possible, the ACO shall utilize the DCMA Quick-Closeout Class Deviation (Reference (m)).

3.5.1.1. Pursuant to the DCMA Quick-Closeout Class Deviation (Reference (m)), the ACO shall close specific contracts prior to the establishment of indirect cost rates regardless of dollar value or the percent of unsettled direct costs and indirect costs allocable to the contract. The criteria for using this deviation are listed below.

3.5.1.1.1. The contractor has submitted the final certified indirect cost rate proposal for the contract under consideration that has been audited by DCAA/A, DCAA/A has provided a non-audit opinion for consideration by the ACO, or the ACO received a Low-Risk ARM from DCAA.

3.5.1.1.2. This deviation for Quick-Closeout Procedures applies to Cost-Reimbursement, Fixed-Price Incentive, Fixed-Price Redeterminable and Time-and-Materials Contracts.

3.5.1.1.3. ACOs must use either DCAA/A-recommended rates or other rates mutually agreed to by the ACO and the contractor in determining the final indirect expenses. In selected instances, the ACO may waive the audit requirement when compelling reasons exist. The decision to waive the audit must be made by the cognizant ACO in consultation with DCAA/A.

3.5.1.1.4. ACOs must ensure contract closeout under this deviation does not impact the Government's negotiation flexibility on the remaining unsettled contracts. Indirect cost rates used under this deviation must not be considered as setting binding precedent when establishing the final indirect cost rates for other contracts.

3.5.1.1.5. ACOs shall not use this deviation if there are significant open cost issues such as Cost Accounting Standards noncompliances or issues in litigation.

3.5.1.1.6. ACOs must document a risk assessment that considers the contractor's accounting, estimating, and/or purchasing systems, and any DCAA/A concerns and any other pertinent information as per FAR 42.708(a)(3) (Reference (d)), before using this deviation to exceed the \$1,000,000 or 10 percent restriction in FAR 42.708(a)(2) (Reference (d)). The decision to waive the audit shall be made by the cognizant ACO in consultation with DCAA/A.

3.5.2. Indirect cost rates used in the quick-closeout of a contract shall not be considered a binding precedent when establishing the final indirect cost rates for other contracts.

3.5.3. The ACO or DACO responsible for settling final indirect rates with a company or division shall negotiate quick-closeout rates if (after conditions covered in paragraphs 3.5.4. and 3.5.4.1. are met) they are determined appropriate. If the ACO or DACO responsible for settling final indirect rates has not negotiated quick-closeout rates, the ACO responsible for closing the contract(s) may negotiate quick-closeout agreements for contracts for which they are responsible. The responsible ACO shall develop the quick-closeout rates in accordance with the quick-closeout procedures covered in paragraphs 3.5.1. through 3.5.1.1.6.; and paragraph 3.5.5. The DCMA "Contract Closeout Guidebook" (Reference (n)) can be a helpful guide in the contract closeout process.

3.5.4. Prior to negotiating quick-closeout rates, the responsible ACO, other affected ACOs, and DCAA/A auditors shall discuss possible reasons for not using the quick-closeout procedure.

3.5.4.1. A DACO shall coordinate with the CACO and/or other affected DACOs to determine if negotiating quick-closeout rates could restrict the CACO's or other DACOs' ability to negotiate corporate or division cost flow-downs (especially those negotiated under the DCMA Quick-Closeout Class Deviation (Reference (m))).

3.5.4.2. If the responsible ACO is a DACO, ACOs who administer contracts affected by the rate year(s) shall identify the affected contract(s) and provide to the DACO justification for use of quick-closeout procedures for the identified contract(s). The ACOs shall also obtain input from the contractor on the affected contract(s) and reach a mutual agreement on an identified listing.

3.5.5. Once an agreement is reached for the affected contract(s), the responsible ACO shall develop the quick-closeout rates and prepare a PNOM in accordance with paragraph 3.6. of this Instruction. The PNOM may be tailored to fit the specific requirements of quick-closeout procedures. ACOs shall obtain management review/concurrence with the PNOM from the appropriate Director before entering into negotiations. CACO/DACO supervisors are designated (by their director) to review PNOMs prepared by CACOs/DACOs (see paragraph 3.6.5.).

3.5.6. As applicable, responsible ACOs shall negotiate quick-closeout rates (i.e., mutually agreed to final indirect rates for closing a specific contract) in accordance with the guidance found in the DCMA Quick-Closeout Class Deviation (Reference (m)).

3.5.7. The ACO shall document the quick-closeout negotiation using a written rate agreement and PNM in accordance with paragraph 3.8.

3.5.7.1. The PNM may be tailored according to guidance found in the DCMA “Quick-Closeout Desktop Procedure” (Reference (o)).

3.5.7.2. DACOs shall obtain CACO/DACO supervisory review/concurrence of the written rate agreement and PNM.

3.5.7.3. The DACO shall provide the PNM to applicable ACOs and DCAA/A auditors for further distribution as needed.

3.5.8. The responsible ACO shall execute the quick-closeout agreement document with the contractor and distribute copies to other ACOs (if applicable) and DCAA/A. The quick-closeout agreement document shall identify all affected contract(s). See the DCMA, “Contract Closeout Guidebook” (Reference (n)) and paragraphs 3.8.5. through 3.8.7. of this Instruction for additional guidance.

3.6. DEVELOP AND COORDINATE PRE-NEGOTIATION OBJECTIVES MEMORANDUM (PNOM).

3.6.1. Except when using a DCAA ARM (see paragraph 3.3.3.), the ACO shall develop the PNOM as governed in FAR 15.406-1 (Reference (d)). The PNOM represents the ACO’s initial negotiation position. The scope and depth of the analysis supporting the PNOM shall be directly related to the dollar value, importance, and complexity of the contractor’s overall rates and individual elements of costs.

3.6.1.1. In circumstances where an ACO has issued a Contracting Officer’s Final Decision (COFD) – such as the issuance of a COFD on a disallowance of costs (see paragraph 3.9.) or on a penalty assessment (see paragraph 3.10) – yet later the ACO is able to engage in a post-COFD negotiated settlement, the ACO must still prepare a PNOM and obtain appropriate management review before finalizing the post-COFD negotiated settlement. An ACO should be aware that, in some instances, negotiations that occurred after issuance of a COFD and prior to contractor appeal were legally held to constitute a rescission of the COFD. An ACO must consult with assigned legal counsel before engaging in negotiations or settlement discussions with the contractor during the post-COFD time period and prior to contractor appeal.

3.6.2. The ACO shall fully consider all DCAA/A questioned, unsupported, and unresolved costs as well as obtain any clarifications from DCAA/A needed to understand the recommendations and findings in the DCAA/A audit report. (Costs questioned by DCAA may also be reported through DCAA Form 1. See paragraph 3.9.2.) As applicable, and in the same

manner as dealing with DCAA/A, the ACO shall fully consider and understand recommendations received from technical specialists.

3.6.2.1. The ACO shall not make a final decision on any questioned costs until obtaining adequate documentation from the contractor. Pursuant to FAR 42.705-1(b)(4) (Reference (d)), the ACO shall obtain DCAA/A's follow-up opinion on the allowability of the costs after their review of the additional documentation provided by the contractor. The auditor's opinion may be provided in writing or orally (but must be documented in an MFR by the ACO if provided orally).

3.6.3. The ACO shall document in the PNOM:

3.6.3.1. An affirmative statement that the ACO agreed or disagreed with each finding and recommendation made by DCAA/A or DCMA specialists (e.g., price/cost analyst, engineer, counsel) and whether or not the assessment of any recommended penalties and interest is appropriate. (See paragraphs 3.10., 3.11., 3.12., and 3.13. of this Instruction for more information about penalties and interest.)

3.6.3.2. Sound rationale for resolving each finding and recommendation made by DCAA/A or DCMA technical specialists and whether or not associated penalties and interest are to be assessed. The rationale must demonstrate that the ACO has considered all appropriate FAR, DFARS, DoD policy, and DCMA Instructions related to the issue raised or questioned by DCAA/A (e.g., cost principles or cost accounting standards).

3.6.4. The ACO shall invite contracting offices having significant dollar interest to participate in the preliminary discussions of critical issues in accordance with FAR 42.705-1(b)(3) (Reference (d)). Also, individuals or offices that have provided a significant input to the Government position shall be invited to participate.

3.6.5. The ACO shall obtain management review/concurrence with the PNOM from the appropriate Director, and any required BoR advisory review (see DCMA-INST 134 (Reference (j))), before entering into negotiations. (However, a BoR is not necessary for a post-COFD negotiated settlement (see paragraph 3.6.1.1.) reached while the matter is in active litigation.) A Director may delegate management-level review of the PNOM to a level no lower than the contract team supervisor/leader.

3.6.6. The appropriate CMO contracts director or CACO/DACO group director shall verify that the ACO is following procedures contained in DCMA-INST 126 (Reference (g)), before approving the PNOM.

3.7. NEGOTIATE RATES.

3.7.1. The ACO shall make every effort to negotiate final overhead rates within a 27- or 36-month cycle (the two noted cycles are defined in paragraphs 3.7.1.2. and 3.7.1.3.) for major and non-major contractors, respectively. However, the ACO shall negotiate all questioned costs

in a timely manner and, if appropriate, assert a Government claim as governed by FAR 33.206 (Reference (d)). Timely final indirect rate settlements are also needed within 36 months of the month in which the contracting officer receives evidence of physical completion of a contract as governed by FAR 4.804-1(a)(3) (Reference (d)).

3.7.1.1. DCAA's definition of a major contractor (over \$100 million of auditable dollar volume) shall be used in determining whether a contractor is classified as major or non-major.

3.7.1.2. For a non-major contractor, the 36-month cycle is computed from the contractor's FYE date to the date the ACO obtains a signed rate agreement settlement.

3.7.1.3. For a major contractor, the 27-month cycle is computed from the contractor's FYE date to the date the ACO obtains a signed rate agreement settlement.

3.7.2. If final indirect rates are determined by the ACO, then the ACO shall negotiate final indirect rates or unilaterally establish final rates.

3.7.2.1. The ACO shall invite contracting offices having significant dollar interest to participate in the negotiation per the requirements of FAR 42.705-1(b)(3) (Reference (d)). The ACO, whenever possible, shall invite the auditor to serve as an advisor at negotiations in accordance with FAR 42.705-1(b)(4) (Reference (d)).

3.7.2.2. The ACO shall negotiate and finalize all local issues under his/her cognizance while waiting for applicable corporate or other flow-down costs.

3.7.2.2.1. When settling all local cost matters, the ACO shall follow the guidance on PNOM and PNM documentation found at paragraphs 3.6. and 3.8. respectively. Likewise, the ACO shall obtain a written agreement with the contractor that documents settlement of specific local cost items. The ACO should look at the resource page of this Instruction for various template documents.

3.7.2.2.2. Upon receipt of applicable corporate or other flow-down costs, the ACO shall finalize the rate agreement settlement.

3.7.2.3. ACOs shall execute final rate agreements for a segment/division when unsettled flow-down costs (e.g., corporate, other segments, or service centers) do not apply to that segment/division.

3.7.2.4. As provided by FAR 52.216-7(d)(4) and FAR 52.233-1 (Reference (d)), if the ACO and contractor are unable to reach agreement on the final annual indirect costs rates, such shall be a dispute within the meaning of the "Disputes" clause (i.e., FAR 52.233-1 (Reference (d))) of the contract, and the ACO shall unilaterally establish the rates and issue a unilateral rate determination letter to the contractor.

3.8. EXECUTE WRITTEN INDIRECT RATE AGREEMENT AND PRICE NEGOTIATION MEMORANDUM (PNM).

The ACO shall properly document the final written indirect rate agreement and PNM. The ACO should look at the resource page of this Instruction for various template documents. (In conjunction with the guidance found in paragraph 3.6.1.1., if an ACO is able to engage in a post-COFD negotiated settlement, the ACO must still prepare a PNM and obtain appropriate management review before finalizing the post-COFD negotiated settlement.)

3.8.1. In accordance with FAR 52.216-7(d)(3) (Reference (d)), the ACO shall prepare a written rate agreement that specifies:

3.8.1.1. The agreed upon final annual indirect cost rates.

3.8.1.2. The bases to which the rates apply.

3.8.1.3. The periods for which the rates apply.

3.8.1.4. Any specific indirect costs items treated as direct costs in the settlement.

3.8.1.5. The affected contracts and/or subcontract, identifying any with advance agreements or special terms and the applicable rates.

3.8.1.6. The understanding shall not change any monetary ceiling, contract obligation, or specific cost allowance or disallowance provided for in this contract. The understanding is incorporated into this contract upon execution.

3.8.1.7. Additionally, the contractor is required to update the billings on all contracts to reflect the final settled rates and update the schedule of cumulative direct and indirect costs claimed and billed within 60 days after settlement of final indirect cost rates in accordance with FAR 52.216-7(d)(2)(v) (Reference (d)). However, the requirement of FAR 52.216-7(d)(2)(v) (Reference (d)) only applies to contracts which contain the version of FAR 52.216-7 (Reference (d)), effective on or after May 31, 2011.

3.8.2. Except when using DCAA ARM (see paragraph 3.3.3.), the ACO shall prepare a PNM containing:

3.8.2.1. An affirmative statement that the ACO agreed or disagreed with each finding and recommendation made by DCAA/A or DCMA specialists (e.g., price/cost analyst, engineer, or counsel) and whether or not the assessment of any penalties and interest is appropriate. (See paragraphs 3.10., 3.11., 3.12., and 3.13. of this Instruction for more information about penalties and interest.)

3.8.2.2. Sound rationale for resolving each finding and recommendation made by DCAA/A or DCMA specialists, and whether or not the assessment of any penalties and interest is appropriate. The rationale must demonstrate that the ACO has considered all appropriate

FAR, DFARS, and DCMA Instructions related to the issue raised or questioned by DCAA/A (e.g., cost principles or cost accounting standards). Additionally, the ACO must separately identify all inter-company flow-down costs used to reach a local final indirect rate settlement. This will document that the ACO properly identified and considered the impact of other negotiated inter-company flow-down costs (by comparing what was proposed versus what was settled by the CACO or cognizant DACOs). Further, the ACO must document his/her rationale for not using, or waiting for, final settled inter-company flow-down costs.

3.8.2.3. A reconciliation of all costs questioned with identification of items and amounts allowed or disallowed in the final settlements as well as the disposition of period costs or allocability issues including the assessment of any penalties and interest. Also explain any deviations taken from a prior position contained in the PNOM relative to reaching the final settlement.

3.8.2.4. A reconciliation of all costs that were considered unallowable and the respective amounts of the disallowance including the assessment of any penalties and interest.

3.8.2.5. An identification of cost or pricing data submitted during the negotiations and relied upon in reaching settlement including the assessment of any penalties and interest.

3.8.3. Before signing the rate agreement and PNM, the ACO shall seek management review of the written rate agreement and PNM. This management review must include the appropriate director as well as any required follow-up BoR evaluation when the ACO deviates from a prior BoR recommendation on the PNOM (see paragraph 3.6.5.). The ACO shall follow guidance in DCMA-INST 134 (Reference (j)) regarding post-BoR deviations. However, a BoR is not necessary for a post-COFD negotiated settlement (see paragraph 3.6.1.1.) reached while the matter is in active litigation.

3.8.4. Before concluding management review of the rate agreement and PNM, the appropriate CMO contracts director or CACO/DACO group director shall verify that the ACO followed procedures contained in DCMA-INST 134 (Reference (j)). A Director may delegate management-level review of the action to a level no lower than the contract team supervisor/leader.

3.8.5. After obtaining the review/concurrence covered in paragraphs 3.8.3. and 3.8.4., the ACO shall sign and distribute the rate agreement and PNM in accordance with FAR 42.706 (Reference (d)).

3.8.5.1. The ACO shall promptly distribute an executed copy of the rate agreement to the contractor.

3.8.5.2. The ACO shall promptly distribute executed copies of the rate agreement and PNM to each affected contracting office and DCAA/A.

3.8.6. The ACO shall document in the contract file both the date and method of transmittal of the PNM to DCAA/A. ACOs shall document completion of the rate settlement in the Overhead Negotiations eTool as stipulated in paragraph 3.14.1.

3.8.7. In conjunction with paragraph 3.8.1.5., the ACO may encounter instances where contractors do not submit timely contract completion invoices or vouchers. In such instances, the ACO shall follow guidance found in FAR 42.705(c) (Reference (d)).

3.9. SETTLE FORM 1 ISSUES AND DISALLOWANCE OF COST ISSUES.

3.9.1. If DCAA is unable to reach agreement with the contractor on audit determined rates then DCAA will issue a DCAA Form 1. When the ACO receives a DCAA Form 1 the ACO shall follow the procedures in paragraphs 3.6. through 3.8. to resolve the issue and settle the final rates. As covered in in DCMA-INST 128 (Reference (e)), an ACO may need to issue a COFD when a contractor files a claim or dispute in response to a DCAA Form 1.

3.9.2. During the course of performance on contracts the ACO may become aware of indirect costs that have been disallowed by that ACO, by other ACOs, or through DCAA/A issuance of a DCAA Form 1 or memorandum. In such instances, the ACO shall follow guidance found in DCMA-INST 128 (Reference (e)). Disallowed indirect costs shall be considered when developing a PNOM as covered in paragraph 3.6. of this Instruction.

3.9.2.1. The ACO with appropriate delegated authority is responsible to make the determination on cost allowability. If the determination of allowability relates to direct costs, see the guidance found at paragraph 3.9.5.

3.9.2.2. In determining if a cost is allowable or unallowable, the cognizant ACO shall use the basic criteria of allowability (see FAR 31.201-2 (Reference (d))); reasonableness (see FAR 31.201-3 (Reference (d))); allocability (see FAR 31.201-4 (Reference (d))); as well as other more specific cost principles found in FAR Subpart 31.2 (Reference (d)).

3.9.2.2.1. When considering cost reasonableness pursuant to FAR 31.201-3 (Reference (d)), the ACO must consider such questions as:

3.9.2.2.1.1. Do the costs exceed what a prudent business person would expend?

3.9.2.2.1.2. Are competitive business restraints present to keep a cost down?

3.9.2.2.1.3. Has the contractor met the burden of proof to demonstrate that a cost is reasonable?

3.9.2.2.2. The ACO shall consider whether potential unallowable costs have any directly associated costs (see FAR 31.201-6 (Reference (d))) that must also be covered by the ACO's determination. As governed by FAR 31.201-6 (Reference (d)), the contractor is required

to identify and exclude both unallowable costs and their directly associated costs from any billing, claim, or proposal applicable to a Government contract.

3.9.3. A DCAA/A audit of final indirect cost rates may disclose questioned direct costs. If the costs have already been submitted and reimbursed, and the contractor does not concur that the costs in question should be disapproved, then DCAA may prepare a Form 1. The Form 1 might be attached to the DCAA final indirect rate report. Additional information and guidance for administering the disposition of Form 1s can be found in the DCMA-INST 128 (Reference (e)).

3.9.4. As a general rule, questioned direct costs will not impact final overhead rate calculations because the costs are usually part of an allocation base and not in an expense pool. Costs questioned that are part of the allocation base must remain part of the allocation base since they should receive their allocable share of indirect costs.

3.9.5. If DCAA/A reports questioned direct costs incurred, regardless of whether a Form 1 is issued, the contract ACO is still responsible for resolving questioned costs relative to the impacted contract.

3.9.5.1. As explained in FAR 42.201(a) (Reference (d)), “for each contract assigned for administration, the contract administrative office ... shall...” perform appropriate assigned functions covered in FAR 42.302 (Reference (d)). The point to be emphasized from this FAR 42.201 (Reference (d)) citation is the phrase “for each contract assigned.” If an ACO has been delegated responsibilities covered by FAR 42.302(a)(7), (a)(8), and (a)(10) (Reference (d)), the assigned duties are at the “each contract assigned” level. Thus, if a contract administration decision must be made (relative to the allowability of direct costs and resolving issues in controversy), then the ACO delegated these duties must do so relative to the affected contract. It does not matter if direct costs questioned by DCAA/A are also in an allocation base identified in a final indirect rate proposal to be settled by a DACO. The ACO with the delegated duties “for each contract assigned for administration” must settle the questioned direct costs associated with the affected contract.

3.9.5.2. In instances where a DACO receives a DCAA/A incurred cost audit report that identifies questioned direct costs, the DACO should immediately notify (to include providing a copy of the DCAA/A audit report) the contract ACO of the questioned direct costs and appropriate required actions.

3.9.5.3. The receipt of a DCAA Form 1 is a separate contract action from the ACO settling final indirect rates. The receipt of a Form 1 should not preclude settlement of the final indirect rates or disposition of the audit in the CAFU system. (See DCMA-INST 126 (Reference (g)) for disposition requirements when penalties are assessed).

3.9.5.4. Where questioned direct costs are included in a DCAA incurred cost audit addressed to a DACO, disposition of the CAFU record remains with the DACO. Settlement of the direct costs will most likely be accomplished before settlement of all final indirect rates.

However, if all final indirect rates are settled first, and the questioned direct costs are still unsettled, then the DACO must hold the CAFU record open until the questioned direct costs are settled. The DACO shall add pertinent notes in the comments section of the open CAFU record. Such comments should describe why the record is still open and the current status of the ACO relative to settling the questioned direct costs. After the questioned direct costs are settled by the ACO, the DACO can complete disposition of the audit in the CAFU system.

3.10. EVALUATE PENALTIES RECOMMENDED BY DCAA/A.

3.10.1. The ACO shall evaluate whether the contractor claimed unallowable costs that are subject to penalties. The CACO is responsible for assessing or waiving penalties on unallowable costs at the corporate level and any such penalties cannot be sent to a DACO to assess or waive.

3.10.2. If DCAA/A recommends penalties for unallowable costs, the ACO shall follow guidance in FAR 42.709-2 (Reference (d)) to:

3.10.2.1. Determine whether penalties shall be assessed against unallowable costs.

3.10.2.2. Determine whether such penalties must be waived pursuant to FAR 42.709-5 (Reference (d)).

3.10.2.3. Refer to the appropriate Contract Integrity Center counsel if there is a suspicion that the contractor may have knowingly submitted unallowable costs. See DCMA-INST 906, "Reporting Fraud, Waste and Abuse" (Reference (p)).

3.11. DETERMINE TYPES OF PENALTIES. The ACO shall determine the types of penalties to be assessed for contracts governed by FAR 42.709-1 and FAR 52.243-3 (Reference (d)).

3.11.1. In accordance with FAR 42.709-1(a)(1) (Reference (d)), if the indirect cost is expressly unallowable under a cost principle in the FAR or DFARS – that defines the allowability of specific selected costs – the ACO shall assess a penalty (sometimes called by DCAA, "first-level penalty") equal to the sum of the following two components:

3.11.1.1. The amount of the disallowed costs allocated to contracts that are subject to penalties for which an indirect costs proposal has been submitted.

3.11.1.2. Add interest on the paid portion, if any, of the disallowed costs. (Simple interest, not compound interest, shall be assessed against the paid portion of the disallowed costs. Follow the directions set forth in FAR 42.709-4, "Computing Interest" (Reference (d)), to calculate the start date and the amount of interest owed.)

3.11.2. As provided for in FAR 42.709-1(a)(2) (Reference (d)), a second more severe type of penalty may sometimes apply. If the indirect cost was determined to be unallowable for that contractor before proposal submission (FAR 42.709-1(a)(2) (Reference (d))), the penalty

(sometimes called by DCAA, “second-level penalty”) is two times disallowed costs. As true for the “first-level penalty”, interest on paid costs may need to be assessed in conjunction with a “second-level penalty.” Thus, interest must be assessed “on any paid portion of the disallowed costs” in accordance with FAR 42.709(a)(2) and FAR 42.709-4 (Reference (d)). As explained in FAR 42.709-3(b) (Reference (d)), prior determinations of unallowability may be evidenced by any of the following:

3.11.2.1. A DCAA/A Form 1 or advisory memorandum, Notice of Contract Costs Suspended and/or Disapproved, or any similar notice which the contractor elected not to appeal and was not withdrawn by the cognizant Government agency.

3.11.2.2. A contracting officer final decision which was not appealed.

3.11.2.3. A prior executive agency Board of Contract Appeals or court decision involving the contractor, which upheld the cost disallowance.

3.11.2.4. A determination or agreement of unallowability under FAR 31.201-6 (Reference (d)).

3.11.2.5. Generally, costs directly associated (see paragraph 3.9.2.2.2.) with expressly unallowable costs are not to be included in the computation of any penalty assessment. However, there is an exception when the directly associated costs meet any of the criteria described in paragraphs 3.11.2.1. through 3.11.2.4. When “directly associated costs” have previously been identified as unallowable to a contractor, they must be added into a “second-level penalty” computation, per FAR 42.709-1(a)(2) (Reference (d)).

3.12. ASSESS PENALTIES AND INTEREST. The ACO shall assess appropriate penalties and interest. (See FAR 42.709-3 and FAR 42.709-4 (Reference (d))).

3.12.1. Unless a waiver is required pursuant to paragraph 3.13. of this Instruction, the ACO shall assess the appropriate type of penalty described in prior paragraph 3.11.

3.12.2. If the unallowable indirect cost is subject to penalty, and the contractor has been paid for these expressly unallowable costs through the interim billing process, the ACO shall compute the applicable interest portion of the penalty using the procedures at FAR 42.709-4 (Reference (d)). The assessment of interest is covered in paragraphs 3.11.1.2. and 3.11.2.

3.12.3. To assess the penalties, the ACO shall issue a final decision in accordance with FAR 33.211 (Reference (d)) that includes a demand for payment of any penalty assessed. The letter shall state that the determination is a final decision under contract clause FAR 52.233-1 (Reference (d)) of the contract. Demanding payment of the penalty is separate from demanding repayment of any paid portion of the disallowed cost. An ACO’s final decision may need to cover either matter or both matters (as appropriate under the circumstances). See DCMA-INST 905, “Contract Claims and Disputes” (Reference (q)), for any applicable guidance related to an ACO issuing a final decision.

3.12.3.1. When a contractor has been paid for any unallowable costs billed to the Government, the ACO shall issue a final decision demanding repayment for any paid portion of a disallowed cost unless the exception in FAR 32.604(c) (Reference (d)) is applicable.

3.12.3.2. If a penalty is assessed on an unallowable cost claimed in a final indirect rate proposal, the ACO shall issue a final decision demanding the payment of the assessed penalty and interest due (as computed in accordance with FAR 42.709-3 and FAR 42.709-4 (Reference (d))).

3.12.3.3. In some instances a contractor may use decremented billing rates and claim that the Government was never billed for unallowable costs because the contractor intentionally decremented their billing rates to prevent the billing of unallowable costs. It is possible that a contractor may demonstrate that no repayment of billed costs with interest is due because the contractor's decremented billings sufficiently cover for all unallowable costs that are perchance included in the submitted final indirect cost rate proposal. However, the assessment of penalty may still be required because a penalty assessment is to be applied to unallowable costs presented in the final indirect rate proposal regardless of what was claimed in interim billings.

3.12.4. The ACO shall document in the contract file copies of the final decision letter and any other appropriate documents. The ACO shall also document the date and method of transmitting to DCAA a copy of the final decision letter.

3.13. WAIVE PENALTIES.

3.13.1. The ACO shall waive the penalties found at FAR 42.709-1(a) when any one of the three conditions identified in FAR 42.709-5 (Reference (d)) are met. The three possible conditions are:

3.13.1.1. The contractor withdraws the proposal before the Government formally initiates an audit of the proposal and the contractor submits a revised proposal. An audit shall be deemed formally initiated when the Government provides the contractor with written notice, or holds an entrance conference, indicating that audit work on a specific final indirect cost proposal has begun.

3.13.1.2. The amount of the unallowable costs under the proposal which are subject to the penalty is \$10,000 or less (i.e., if the amount of expressly or previously determined unallowable costs which would be allocated to the contracts specified in FAR 42.709(b) (Reference (d)) is \$10,000 or less).

3.13.1.2.1. The \$10,000 or less computation equals the aggregate amount of each type unallowable cost (i.e., costs submitted in the final indirect rate proposal) subject to penalty added together to arrive at a total of all such costs allocated to contracts covered by FAR 42.709(b) (Reference (d)).

3.13.1.3. The contractor demonstrates, to the cognizant contracting officer's satisfaction, that the below two conditions are met:

3.13.1.3.1. It has established policies, personnel training, and an internal control and review system that provide assurance that unallowable costs subject to penalties are precluded from being included in the contractor's final indirect cost rate proposals. (Examples of these types of internal controls are controls required for satisfactory participation in the DoD-sponsored self-governance programs, specific accounting controls over indirect costs, compliance tests which demonstrate that the controls are effective, and Government audits which have not disclosed recurring instances of expressly unallowable costs.)

3.13.1.3.2. Additionally, the unallowable costs subject to the penalty were inadvertently incorporated into the proposal; this is to say their inclusion resulted from an unintentional error, notwithstanding the exercise of due care.

3.13.1.3.3. Although not required, the ACO may deem it valuable to obtain legal review prior to granting a waiver pursuant to FAR 42.709-5(c) (Reference (d)).

3.14. MAINTAIN eTOOLS DATABASE. The CMO director or CACO/DACO group director shall establish internal controls to ensure data integrity within the Overhead Negotiations eTool.

3.14.1. ACOs are responsible for the accuracy of data (under their cognizance) contained in the Overhead Negotiations eTool database. The status of each step in the settlement process shall be updated as needed to keep the information current. The use of the database is mandatory for both ACO negotiated and audit-determined final indirect rates.

3.14.2. Supervisory-level staff shall verify the integrity of ACO related entries in the Overhead Negotiation eTool.

3.14.3. The Operations Directorate and the Pricing Center shall perform, and report the results of, semi-annual data integrity tests (October testing of September data and April testing of March data) of records identified with their Department of Defense Activity Address Code(s) (DoDAAC) in the Overhead Negotiation eTool.

3.14.3.1. The data testing methodology shall include summarizing the results to identify:

3.14.3.1.1. The methodology of the data tests.

3.14.3.1.2. The data fields tested.

3.14.3.1.3. The count of the records and data fields tested.

3.14.3.1.4. The date of completion of the data integrity tests.

3.14.3.1.5. The percentages of accuracy or inaccuracy for records and data fields tested. For example, report comments might say, “Eighty percent (20 of 25) records tested in the Overhead Negotiations eTool contained accurate data in all data fields. Eighty percent (4 of 5) of the faulty records did not have comments in the Remarks data field. Twenty percent (1 of 5) of faulty records did not have a date in the acceptable proposal date data field.”

3.14.3.2. The results of these semi-annual sample tests shall be provided to the Executive Director, Contracts, by the end of October and April of each year.

3.14.4. As needed, ACOs or other designated personnel shall make appropriate corrections to faulty records in the Overhead Negotiations eTool database.

GLOSSARY

DEFINITIONS

Claim. FAR 2.101 (Reference (d)) defines a claim as a “a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. However, a written demand or written assertion by the contractor seeking the payment of money exceeding \$100,000 is not a claim under the Contract Disputes Act of 1978 (see FAR 33.202 (Reference (d))) until certified as required by the Act. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the converting officer as provided in [FAR] 33.206(a) (Reference (d)), if it is disputed either as to liability or amount or is not acted upon in a reasonable time.”

Contracting Officer’s Final Decision (COFD). FAR 33.211 (Reference (d)) describes a COFD as: “a written decision that shall include– (i) A description of the claim or dispute; (ii) A reference to the pertinent contract terms; (iii) A statement of the factual areas of agreement and disagreement; (iv) A statement of the contracting officer’s decision, with supporting rationale;” (v) Authorization for a contractor to appeal the decision; and “(vi) Demand for payment prepared in accordance with [FAR] 32.604 (Reference (d)) and [FAR] 32.605 (Reference (d)) in all cases where the decision results in a finding that the contractor is indebted to the Government.” FAR 52.233-1(c) (Reference (d)) covers “Disputes” and describes a “claim.” See DCMA-INST 905 (Reference (q)), for any applicable guidance related to an ACO issuing a final decision.

Covered Contracts. Covered contracts, for purpose of assessment of penalty per FAR 42.709 (Reference (d)), are contracts in excess of \$700,000, and which contain one of the clauses at FAR 52.216-7 (Reference (d)), FAR 52.216-16 (Reference (d)), or FAR 52.216-17 (Reference (d)), or a similar clause from an executive agency’s supplement to the FAR, except fixed-price contracts without cost incentives or any firm-fixed price contracts for the purchase of commercial items. (See FAR 42.709-6) (Reference (d)).

Delivery Order. FAR 2.101 (Reference (d)) defines a delivery order as “an order for supplies placed against an established contract or with Government sources.”

Direct Costs. As defined in FAR 2.101 (Reference (d)), “ ‘Direct cost’ means any cost that is identified specifically with a particular final cost objective. Direct costs are not limited to items that are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.”

Directly Associated Costs. Per FAR 31.201-6 (Reference (d)), “A directly associated cost,” is described as, “any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.”

Expressly Unallowable Costs. FAR 31.001 (Reference (d)) provides that an “ ‘expressly unallowable cost’ means a particular item or type of cost which, under the express provisions of an applicable law, regulation, or contract, is specifically named and stated to be unallowable.”

Final Indirect Cost Rate Proposal. Final indirect cost rate proposals are covered in FAR clause 52.216-7(d) (Reference (d)) where it explains that a “Contractor shall submit an adequate final indirect cost rate proposal to the Contracting Officer (or cognizant Federal agency official) and auditor within the 6-month period following the expiration of each of its fiscal years.” FAR 52.216-7(d)(2)(iii) (Reference (d)) identifies the criteria for an “adequate indirect cost rate proposal.”

Form 1. DCMA-INST 128, (Reference (e)) provides detailed guidance regarding ACO involvement with DCAA Form 1s. DCAA has sole responsibility for approving interim vouchers for provisional payment (this includes approving the fee portion of vouchers in accordance with the contract schedule and ACO instructions) and sending them to Defense Finance and Accounting Service or other payment office. As part of that responsibility, DCAA is responsible for issuing DCAA Form 1, Notice of Contract Costs Suspended and/or Disapproved, when allowability of the costs billed in the interim vouchers is questionable (DFARS 242.803(b)(i)) (Reference (r)). Host nation auditors will not supply a DCAA Form 1 but may supply an advisory memorandum.

Indirect Costs. As defined in FAR 2.101 (Reference (d)), “ ‘Indirect cost’ means any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.”

Major Contractor. This is a contractor that has auditable cost reimbursable contracts that incur more than \$100 million in claimed costs in a fiscal year. The auditable dollar threshold distinction for “major” versus “non-major contractors” can vary as DCAA management may decide in a given fiscal year. A good source for identifying the current dollar threshold distinction is found in section 5-111.1 of a current DCAA Contract Audit Manual (Reference (s)).

Non-major Contractor. This is a contractor that has auditable cost reimbursable contracts that incur \$100 million or less in claimed costs in a fiscal year.

Task Order. FAR 2.101 (Reference (d)) defines a task order as “an order for services placed against an established contract or with Government sources.”

Unallowable Costs. As defined in FAR 2.101 (Reference (d)), “ ‘Unallowable cost’ means any cost that, under the provisions of any pertinent law, regulation, or contract, cannot be included in

prices, cost-reimbursements, or settlements under a Government contract to which it is allocable.”

GLOSSARY

ACRONYMS

ACO	Administrative Contracting Officer
ARM	Adequacy Review Memorandum(s)
BoR	Boards of Review
CACO	Corporate Administrative Contracting Officer
CAFU	Contract Audit Follow-Up
CMO	Contract Management Office
COFD	Contracting officer's Final Decision
COR	Contracting Officer's Representative
DACO	Divisional Administrative Contracting Officer
DCAA	Defense Contract Audit Agency
DCAA/A	Defense Contract Audit Agency or other auditors
DCMA	Defense Contract Management Agency
DCMA-INST	DCMA Instruction
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Services
DoD	Department of Defense
DoDAAC	Department of Defense Activity Address Code
DPAP	Defense Procurement and Acquisition Policy
FAR	Federal Acquisition Regulation
FYE	Fiscal Year-End
HQ	Headquarters
MFR	Memorandum for Record
PCO	Procuring Contracting Officer
PLAS	Performance Labor Accounting System
PNOM	Pre-negotiation Objective Memorandum
PNM	Price Negotiation Memorandum