



DEPARTMENT OF DEFENSE
Defense Contract Management Agency

INSTRUCTION

Disallowance of Costs

Contracts Directorate
OPR: DCMA-AQ

DCMA-INST 128
December 4, 2013

1. PURPOSE. This Instruction:

- a. Revises DCMA Instruction (DCMA-INST) 128, “Disallowance of Costs” (Reference (a)).
- b. Is established in compliance with DoD Directive 5105.64, “Defense Contract Management Agency (DCMA)” (Reference (b)).
- c. Implements DoD policy pursuant to the references on page 4.
- d. Establishes policies and assigns responsibility for ensuring that administrative contracting officers (ACO) resolve cost allowability issues (under applicable contracts) by settling with a contractor; issuing a written notice of intent; and/or issuing a final decision to disallow specified costs incurred or planned to be incurred. This guidance also outlines procedures for ACO interaction with the Defense Contract Audit Agency (DCAA) when DCAA auditors (functioning as authorized representatives for the ACO) issue a DCAA Form 1, “Notice of Contract Costs Suspended and/or Disapproved” (Reference (c)).

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 (d)). The process flowchart is located at Appendix A.

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

5. PLAS CODE. Use the PLAS code process associated with the contracting action being supported. Such processes can include:

- a. Process: 043 – Forward Pricing Rate Agreements
044 – Final Overheads
052 – Contract Audit Follow-Up
094 – Contractor Purchasing System Review
112 – Contractor Estimating System Reviews

113 – Material Management Accounting System

116 – Contractor Insurance/Pension Reviews Program

141 – Public Vouchers

156 – Disputes, ADR and Appeals


181 – Contract Closeout

b. Programs: ACAT/Other Customers (when applicable).

c. Other National; Training and Travel; Local Programs (when applicable).

6. POLICY RESOURCE WEB PAGE. <https://home.dema.mil/policy/128r>

7. EFFECTIVE DATE. By order of the Director, DCMA, this Instruction is effective December 4, 2013 and all applicable activities shall be fully compliant within 60 days from this date.



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TABLE OF CONTENTS

REFERENCES	4
CHAPTER 1 – POLICY	
1.1. Policy	5
CHAPTER 2 – RESPONSIBILITIES	
2.1. Regional Commander/Director, Special Programs Director, International Director, Director of the Cost and Pricing Center	8
2.2. Contract Management Office (CMO) Commander/Director, Director of Corporate/Divisional Administrative Contracting Officer Group.....	8
2.3. Administrative Contracting Officer	8
CHAPTER 3 – PROCEDURES	
3.1. ACO Issuance of a Notice of Intent to Disallow Costs (Before a Cost is Incurred).....	9
3.2. ACO Receipt of a Notice (DCAA Form 1) to Disallow Costs (After a Cost Is Incurred).....	13
APPENDIX	
Appendix A. Disallowance of Costs Process Flowchart	18
GLOSSARY	
Definitions.....	29
Acronyms.....	30

REFERENCES

- (a) DCMA Instruction, "Disallowance of Costs," December 2011 (hereby canceled)
- (b) DoD Directive 5105.64, "Defense Contract Management Agency," January 10, 2013
- (c) DFARS 242.803(b)(i)(D), "Disallowing costs after incurrence"
- (d) DCMA-INST 710, "Managers' Internal Control Program," September 12, 2011
- (e) FAR 52.242-1, "Notice of Intent to Disallow Costs"
- (f) FAR 42.801(c), "Notice of intent to disallow costs"
- (g) FAR 42.801(b), "Notice of intent to disallow costs"
- (h) DCMA-INST 134, "Boards of Review," October 15, 2012
- (i) DCMA-INST 126, "Contract Audit Follow-Up," August 22, 2013
- (j) DCMA-INST 125, "Final Overhead Rates," April 12, 2013
- (k) DCMA-INST 809, "Records Management," May 1, 2011
- (l) DCMA-INST 905, "Contract Claims and Disputes," November 1, 2007
- (m) FAR 42.801(a), "Notice of intent to disallow costs"
- (n) FAR 42.803, "Disallowing costs after incurrence"
- (o) DFARS 242.803, "Disallowing costs after incurrence"
- (p) DCMA-INST 123, "Cost Monitoring," August 14, 2013
- (q) FAR 42.302(a)(10), "Contract administration functions"
- (r) FAR 42.302(a)(7), "Contract administration functions"
- (s) DCMA Memorandum #13-192, "Administrative Contracting Officer (ACO) Settlement of Questioned Direct Costs Reported by DCAA," June 21, 2013
- (t) FAR 42.801(f), "Notice of intent to disallow costs"
- (u) FAR 52.301, "Solicitation provisions and contract clauses (Matrix)"
- (v) FAR 31.201-2, "Determining allowability"
- (w) FAR 31.201-3, "Determining reasonableness"
- (x) FAR 31.201-4, "Determining allocability"
- (y) FAR Subpart 31.2, "Contracts with Commercial Organizations"
- (z) FAR 31.201-6, "Accounting for Unallowable Costs"
- (aa) FAR 42.801, "Notice of intent to disallow costs"
- (ab) FAR 42.801(e), "Notice of intent to disallow costs"
- (ac) FAR 42.801(d), "Notice of intent to disallow costs"
- (ad) DCAA Contract Audit Manual (CAM) 6-902, May 17, 2013
- (ae) FAR Part 31, "Contract Cost Principles and Procedures"
- (af) DFARS 242.803(b)(ii)(B), "Disallowing costs after incurrence"
- (ag) FAR 33.211(c), "Contracting officer's decision"
- (ah) FAR 33.211(c)(2), "Contracting officer's decision"
- (ai) DCMA-INST 104, "Contracts Debts," December 11, 2012
- (aj) FAR 2.101, "Definitions"

CHAPTER 1

POLICY

1.1. POLICY.

1.1.1. The ACO has the authority to issue a written notice of intent to disallow costs under cost-reimbursable contracts, fixed-price incentive contracts, and price redeterminable contracts that contain Federal Acquisition Regulation (FAR) clause 52.242-1 (Reference (e)). (NOTE: The term ACO as used in this Instruction can refer to a corporate administrative contracting officer (CACO), a divisional administrative contracting officer (DACO), or ACO unless otherwise specified.)

1.1.2. The ACO can learn of unallowable costs before incurrence or after they have been incurred. Paragraphs 1.1.3. through 1.1.9. cover instances where unallowable costs are discovered before incurrence. Typically DCAA identifies unallowable costs after they are incurred as covered in paragraphs 1.1.10. through 1.1.14. The ACO shall disallow costs determined to be unallowable under the terms of a contract or under cost principles contained in the FAR and any applicable supplement.

1.1.3. After conferring with auditors from DCAA, and after attempting to reach a satisfactory settlement with the contractor, the ACO shall consider issuance (to a contractor) of a written notice of intent to disallow specified costs incurred.

1.1.4. If the notice involves elements of indirect cost (allocated to more than one business unit), the ACO shall not issue a notice without first coordinating with other impacted contracting officers or auditors who deal with other segments of a contractor's organization.

1.1.5. Pursuant to FAR 42.801(c) (Reference (f)), when an ACO issues a notice of intent to disallow costs, the notice shall:

1.1.5.1. Refer to the contract's Notice of Intent to Disallow Costs clause.

1.1.5.2. State the contractor's name and list the numbers of the affected contracts.

1.1.5.3. Describe the costs to be disallowed, including estimated dollar value by item and applicable time periods, and state the reasons for the intended disallowance.

1.1.5.4. Describe the potential impact on billing rates and forward pricing rate agreements.

1.1.5.5. State the notice's effective date and the date by which written response must be received.

1.1.5.6. List the recipients of copies of the notice.

1.1.5.7. Request the contractor acknowledge receipt of the notice.

1.1.6. If an ACO to a multi-segment corporation issues a notice of intent to disallow costs (as covered in paragraph 1.1.4.), the ACO shall furnish copies to all contracting officers cognizant of any segment of the contractor's organization.

1.1.7. The ACO shall provide a contractor an appropriate written response and/or a written decision when:

1.1.7.1. The contractor disagrees with a notice of intent to disallow costs.

1.1.7.2. The contractor disagrees with a notice of suspended payment of costs.

1.1.7.3. The contractor disagrees with a notice of disallowance of costs after incurrence.

1.1.8. When a contractor disagrees with an issued notice covered in paragraph 1.1.5., the ACO shall answer the contractor's written objection by withdrawing the notice or by issuing a written final decision to the contractor within 60 days. See FAR 42.801(b) (Reference (g)).

1.1.9. If contract actions involve disallowance of costs, the ACO shall bring the matter before any required Board of Review (BoR) (Reference (h)) if any of the following conditions exist:

1.1.9.1. The ACO does not agree with a DCAA Form 1, "Notice of Contract Costs Suspended and/or Disapproved."

1.1.9.2. The ACO intends to stop a withhold on cost reimbursable vouchers.

1.1.9.3. The contractor disagrees with the ACO about a cost disallowance.

1.1.10. When DCAA issues a DCAA Form 1, and the contractor does not object, the ACO need not take further action unless the contractor has overbilled on a contract with no future billings under the contract. In such instances, the ACO shall take steps to recoup the disapproved costs (e.g., issue a demand for payment or disapprove costs under another contract as an offset).

1.1.11. When a contractor objects (by a written request or by a claim) to a DCAA Form 1, the ACO shall prepare a written determination to withdraw the notice; or negotiate a settlement; or issue a final decision within 60 days.

1.1.12. Unless other guidance or contractual requirements concerning contract security matters conflict, the ACO shall utilize the DCMA Form 1 Tracking eTool when dealing with disallowed costs after cost incurrence. (NOTE: The DCMA Form 1 Tracking eTool provides a central repository for all DCAA Form 1s issued. This eTool serves as an automated way to create, review, approve, and track DCAA Form 1s.)

1.1.13. The ACO shall provide DCAA a copy of any documentation that dispositions an auditor issued DCAA Form 1.

1.1.14. When a DCAA Form 1 is issued as the result of an audit of a final indirect rate proposal, the ACO shall follow the requirements set forth in DCMA policies of DCMA-INST 126, "Contract Audit Follow-Up" (Reference (i)) and DCMA-INST 125, "Final Overhead Rates" (Reference (j)).

1.1.15. The ACO shall retain documents associated with issuance of notices to disallow or suspend costs as designated by the component Commander/Director and the ACO's supervisor. Additionally, record retention shall conform to DCMA-INST 809, "Records Management" (Reference (k)).

CHAPTER 2

RESPONSIBILITIES

2.1. REGIONAL COMMANDER/DIRECTOR, SPECIAL PROGRAMS DIRECTOR, INTERNATIONAL DIRECTOR, DIRECTOR OF THE COST AND PRICING CENTER.

The appropriate commander/director shall ensure compliance with this Instruction by subordinate contracting staff.

2.2. CONTRACT MANAGEMENT OFFICE (CMO) COMMANDER/DIRECTOR, DIRECTOR OF CORPORATE/DIVISIONAL ADMINISTRATIVE CONTRACTING OFFICER GROUP. The appropriate commander/director shall:

2.2.1. Review the decision-making process of the ACO that leads to the ACO issuing a notice of intent to disallow costs.

2.2.2. Review the decision-making process of the ACO that leads to an ACO withdrawing a notice of intent to disallow costs or executing a final decision.

2.2.3. Ensure that ACOs request a required BoR as governed by DCMA-INST 134, "Boards of Review" (Reference (h)).

2.2.4. Ensure that the ACO, in preparing the contracting officer final decision, seeks advice from assigned legal counsel, the Contract Disputes Resolution Center (CDRC) and other advisors in accordance with the DCMA-INST 905, "Contract Claims and Disputes" policy (Reference (l)).

2.2.5. Not delegate his/her management review authority, regarding this contract action, to a level lower than the contract team supervisor/leader.

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

CHAPTER 3

PROCEDURES

3.1. ACO ISSUANCE OF A NOTICE OF INTENT TO DISALLOW COSTS (BEFORE A COST IS INCURRED).

3.1.1. As noted in FAR 42.801(a) (Reference (m)), discovery of potentially unallowable costs can occur before the costs are incurred or after they are incurred. (**NOTE:** As covered in paragraph 3.2, DCAA audit reports or auditor review of public vouchers (submitted by a contractor) may disclose cost allowability issues. See FAR 42.803 (Reference (n)) and DFARS 242.803 (Reference (o)). In most instances, DCAA reports unallowable costs after they are incurred. The ACO shall refer to paragraph 3.2 of this Instruction when dealing with unallowable costs that are reported after incurrence.) The ACO may learn of costs subject to potential disallowance from several sources such as:

3.1.1.1. Cost monitoring activities may disclose potential cost allowability problems. (**NOTE:** Cost monitoring activities are covered in DCMA-INST 123, Cost Monitoring” (Reference (p)) and the associated resource page.)

3.1.1.2. A DCAA audit of a price proposal or forward pricing rate proposal may disclose a cost allowability issue before a cost is incurred.

3.1.1.3. In some circumstances an ACO may deal with host nation auditors rather than DCAA auditors. If host nation auditors identify a potential cost allowability problem to the ACO the ACO will follow the same steps covered in this policy.

3.1.2. After learning of potential instances of unallowable costs the ACO must identify the contracting officer responsible to settle the matter of controversy. If delegated the authority, an ACO has the responsibility to resolve issues of controversy (see FAR 42.302 (a)(10) (Reference (q)), and to determine the allowability of costs suspended or disapproved pursuant to FAR 42.302 (a)(7) (Reference (r)). Otherwise, the ACO will defer the issue to a procuring contracting officer where the ACO has not been delegated to perform the function as part of contract administration.

3.1.2.1. The ACO (who first learns of the questionable costs) shall consider the type of costs under dispute in order to identify any other ACO who is responsible to determine the allowability.

3.1.2.1.1. If the disputed costs are direct costs, the ACO (who first learns of the questionable costs) shall identify the ACO who has delegated authority to administer the affected contract. The ACO who has delegated authority to administer a contract is the ACO responsible to determine the allowability of questioned direct costs associated with that contract (Reference (s)).

3.1.2.1.2. If the questionable costs involve elements of indirect cost, the ACO shall identify the appropriate ACO responsible for settling final indirect rates impacted by the questioned indirect costs. The ACO responsible for settling final indirect rates shall be responsible to issue the notice to disallow indirect costs. Similarly, the ACO who issues the notice of disallowance must respond to any contractor disagreement with the notice as covered in FAR 42.801(f) (Reference (t)).

3.1.2.1.3. If the questionable costs involve elements of indirect cost allocated to other business segments, the ACO shall coordinate with other impacted contracting officers or auditors who deal with other segments of a contractor's organization. These impacted contracting officers, auditors, and contractor representatives may need to be engaged in discussions to reach a satisfactory settlement.

3.1.2.2. When evaluating costs that might be disallowable, the ACO shall first review the contract(s) to be affected and determine that the contract(s) contain FAR clause 52.242-1 (Reference (e)). **(NOTE:** The FAR Matrix table found at FAR 52.301 (Reference (u)) identifies contract types that require the inclusion of FAR clause 52.242-1 (Reference (e)).)

3.1.2.3. If a contract does not contain, or is not required to contain FAR clause 52.242-1 (Reference (e)), then the ACO shall consult legal counsel as to whether the cost issue can be addressed on this contract or other contracts.

3.1.2.4. When determining cost allowability, the ACO (with appropriate delegated authority) shall use the basic criteria of allowability (see FAR 31.201-2 (Reference (v))); reasonableness (see FAR 31.201-3 (Reference (w))); allocability (see FAR 31.201-4 (Reference (x))); as well as other more specific cost principles found in FAR Subpart 31.2 (Reference (y)).

3.1.2.4.1. When considering cost reasonableness (FAR 31.201-3, Reference (w)), the ACO must consider such questions as:

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

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

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

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

3.1.2.4.3. If the ACO determines a cost to be allowable, no additional action is needed unless an ACO disagreement with DCAA audit findings requires a BoR (DCMA-INST 134, Reference (h)).

3.1.3. As required in FAR 42.801(a) (Reference (m)), the ACO responsible for administering a contract shall make every reasonable effort to reach a satisfactory settlement of the unallowable cost finding through discussions with the contractor.

3.1.4. If the ACO and the contractor do not agree on the allowability of the costs, the ACO shall consider issuance of a notice of intent to disallow the costs in accordance with FAR 42.801 (Reference (aa)).

3.1.5. Before issuing a notice that involves elements of indirect costs, the ACO shall first seek advice from the cognizant DCAA office that provides audit support for settlement of final indirect cost rates (FAR 42.801(e)) (Reference (ab)). After obtaining input from DCAA, the ACO responsible for settling final indirect rates shall be responsible to issue the notice to disallow indirect costs (as well as dealing with any contractor disagreement with a notice as covered in FAR 42.801(f) (Reference (t))).

3.1.6. Before issuing the notice of intent to disallow costs, the ACO shall obtain management review of the notice from the CMO Contracts Director and any required BoR (DCMA-INST 134, Reference (h)). Before issuing the notice of intent to disallow costs, CACOs and DACOs shall obtain management review of the notice from the Director of Corporate/Divisional Administrative Contracting Officer Group. If this action is delegated, the appropriate Director must delegate to a level no lower than the contract team supervisor/leader.

3.1.7. If the ACO issues a notice of intent to disallow costs, it shall (FAR 42.801(c)) (Reference (f)):

3.1.7.1. Refer to the contract's Notice of Intent to Disallow Costs clause.

3.1.7.2. State the contractor's name and list the numbers of the affected contracts.

3.1.7.3. Describe the costs to be disallowed, including estimated dollar value by item and applicable time periods, and state the reasons for the intended disallowance.

3.1.7.4. Describe the potential impact on billing rates and forward pricing rate agreements.

3.1.7.5. State the notice's effective date and the date the contractor must provide a written response.

3.1.7.6. List the recipients of copies of the notice.

3.1.7.7. Request the contractor to acknowledge receipt of the notice.

3.1.8. If the contractor submits a timely (within the time period specified in subparagraph 3.1.7.5.) written response that it disagrees with the notice, the ACO shall withdraw the notice or issue a final decision (FAR 42.801(f)) (Reference (t)).

3.1.9. If the ACO withdraws the notice the following steps must be taken:

3.1.9.1. If a DCAA audit report was relied upon, the ACO shall document in a memorandum for record (MFR) to the contract file an affirmative statement that the ACO agreed or disagreed with each audit finding and recommendation along with sound rationale for resolving each audit finding and recommendation. The rationale must demonstrate that the ACO has considered all appropriate FAR, DFARS, and DCMA Instructions related to the issues raised or questioned by DCAA.

3.1.9.2. As applicable, and before issuing a notice of withdrawal, the ACO shall obtain management review of both the MFR and the withdrawal notice.

3.1.9.2.1. The withdrawal notice documentation shall be reviewed by the CMO Contracts Director, however, CACOs and DACOs shall obtain management review from the Director of Corporate/Divisional Administrative Contracting Officer Group. (**NOTE:** If this action is delegated, the noted Directors must delegate to a level no lower than the contract team supervisor/leader.)

3.1.9.2.2. The withdrawal notice documentation shall be reviewed by any required BoR (DCMA-INST 134, Reference (h)).

3.1.9.3. The ACO shall issue the withdrawal notice within 60 days of receipt of the contractor's written response. See FAR 42.801(b) (Reference (g)).

3.1.10. If the ACO must issue a final decision the following steps must be taken:

3.1.10.1. Where a DCAA audit report was relied upon, the ACO shall document in the final decision letter, and in a memorandum for record (MFR) to the contract file, an affirmative statement that the ACO agreed or disagreed with each audit finding and recommendation along with sound rationale for resolving each audit finding and recommendation. The rationale must demonstrate that the ACO has considered all appropriate FAR, DFARS, and DCMA Instructions related to the issues raised or questioned by DCAA. Additionally, the ACO shall document, in the MFR, the date of discovery of the unallowable cost.

3.1.10.2. As applicable, and before executing a final decision, the ACO shall obtain management and legal review.

3.1.10.2.1. The final decision shall be reviewed by CMO Contracts Director, however, CACOs and DACOs shall obtain management review from the Director of Corporate/Divisional Administrative Contracting Officer Group. (**NOTE:** If this action is delegated, the noted Directors must delegate to a level no lower than the contract team supervisor/leader.)

3.1.10.2.2. The final decision shall be reviewed by any required BoR (DCMA-INST 134, Reference (h)).

3.1.10.2.3. The ACO and the CMO Contracts Director, CACOs, DACOs and the Director of Corporate/Divisional Administrative Contracting Officer Group, should ensure that, in preparing the contracting officer final decision, advice is obtained from assigned legal counsel, the Contract Disputes Resolution Center (CDRC) and other advisors in accordance with DCMA-INST 905 (Reference (l)) policy.

3.1.10.3. The ACO shall issue a final decision within 60 days of receipt of the contractor's written response. See FAR 42.801(b) (Reference (g)).

3.1.11. When applicable, the ACO shall furnish copies of any type notice (notice of intent to disallow costs, withdrawal notice, or final decision) to "all contracting officers cognizant of any segment of the contractor's organization" (even if a segment is not impacted by indirect cost allocations). See FAR 42.801(d) (Reference (ac)).

3.1.12. The ACO shall maintain copies of all final versions of audit reports, MFRs, written communications, legal advice, management review documents, written notices, and final decision documents as stated or implied elsewhere in this Instruction. Additionally, the ACO shall make sure that all these records are maintained in accordance with DCMA-INST 809 (Reference (k)).

3.2. ACO RECEIPT OF A NOTICE (DCAA FORM 1) TO DISALLOW COSTS (AFTER A COST IS INCURRED).

3.2.1. As stated in paragraph 3.1.1., ACOs may become aware of suspended or disallowed costs after their incurrence through DCAA audit reports and/or auditors issuing a DCAA Form 1, "Notice of Contract Costs Suspended and/or Disapproved," to a contractor. DCAA auditors will generally use the DCMA Form 1 Tracking eTool to create and release a DCAA Form 1 to the ACO. This eTool is discussed in paragraph 3.2.10.

3.2.1.1. The DCAA Contract Audit Manual (Reference (ad)) describes "suspended" costs as, "an item of cost, either direct or indirect, which lacks adequate explanation or documentary support for definitive audit approval or disapproval." Such costs "should be suspended until the required data are received and a determination can be made as to the allowability of the item."

3.2.1.2. DCAA describes (Reference (ad)) "disapproved" costs as, "Costs claimed by the contractor for which audit action has been completed, and which are not considered allowable." "Disapproved costs" may involve the following:

3.2.1.2.1. "Disapproved costs" may involve cost restrictions governed by FAR Part 31 (Reference (ae)) or terms of a contract.

3.2.1.2.2. “Disapproved costs” may involve a cost that is not explicitly unallowable under FAR Part 31 (Reference (ae)) but are considered by the auditor “to be unreasonable in amount, contrary to generally accepted accounting principles, or not properly allocable to the contract in accordance with the relative benefit received or other equitable relationship.”

3.2.1.2.3. “Disapproved costs” may involve costs previously disapproved by the ACO.

3.2.1.2.4. Additionally, the ACO must consider whether the identified unallowable costs have directly associated costs (as covered in FAR 31.201-6 (Reference (z))) even if such costs are not identified by DCAA. Also see subparagraph 3.1.2.4.2. If DCAA does not identify such costs in a DCAA Form 1, the ACO shall make inquiry about directly associated costs that may need to be further identified by DCAA.

3.2.2. In some instances where final indirect rate proposals are classified as “auditor determined,” the contractor will not agree to exclude auditor questioned costs from inclusion in final indirect rates. Thus, the contractor will not sign a rate agreement for the DCAA auditor. When this occurs, DCAA will attach a DCAA Form 1 to an incurred cost audit report that is provided to the ACO. The rate settlement then switches from being “auditor determined” to “ACO determined.” The ACO shall follow the procedures in the DCMA-INST 125 (Reference (j)) for settling the final indirect rates.

3.2.3. In cases where the contractor does not agree with DCAA’s position on disallowed costs identified in a DCAA Form 1, the comment/text within the form will typically contain language requesting the ACO to issue a final decision.

3.2.4. In circumstances where an ACO is dealing with host nation auditors rather than DCAA auditors, the host nation auditors may identify cost allowability issues to an ACO. In such cases, the ACO will generally follow the same steps covered in paragraph 3.2. However, since host nation auditors do not use the DCAA Form 1, the ACO shall create a DCAA Form 1 (if future contractor billings of the unallowable costs can still occur) in the DCMA Form 1 Tracking eTool as covered in paragraph 3.2.10. The DCMA Form 1 Tracking eTool provides the means for tracking the cost allowability issue. The ACO should also use the DCAA Form 1 as a ready means to notify the contractor (via issuing a DCAA Form 1 to the contractor) of disallowed costs. ACO use of a DCAA Form 1 is covered in DFARS 242.803(b)(ii)(B) (Reference (af)).

3.2.5. Any DCAA audit might disclose unallowable costs. Typically, however, incurred cost type audits will be the source of reported unallowable costs. Where a DCAA audit is involved, the ACO may be notified by an auditor via a DCAA Form 1 that is separate from an audit report or it may be attached to an audit report.

3.2.6. Although a DCAA Form 1 will likely request the ACO to render a final decision (as noted in paragraph 3.2.3.), the contractor may contact the ACO as well.

3.2.6.1. The contractor may submit a written request to the ACO to consider whether the unreimbursed costs (disallowed by a DCAA Form 1) should be paid.

3.2.6.2. In addition to the written request noted in paragraph 3.2.6.1., the contractor may file a claim or dispute. See claims and disputes under DCMA-INST 905 (Reference (l)).

3.2.7. If the contractor submits a written request asking the ACO to determine whether the unreimbursed costs (disallowed by a DCAA Form 1) should be paid, or files a claim under the Disputes clause, the ACO shall take one or more of these actions:

3.2.7.1. The ACO shall fully consider all DCAA findings and recommendations.

3.2.7.2. The ACO shall prepare a written determination and withdraw the notice within 60 days if the ACO finds that the costs should be paid. See FAR 33.211(c) (Reference (ag)).

3.2.7.3. The ACO shall negotiate a settlement within 60 days (**NOTE:** See DCMA-INST 125 (Reference (j)) relative to documenting this cost settlement into the pre-negotiation objective memorandum (PNOM) used for negotiating the final indirect rates. If the ACO negotiates a settlement on questioned direct costs, the MFR covered in subparagraphs 3.2.7.6. and 3.2.7.6.1. is to be considered the equivalent/substitute for a PNOM.)

3.2.7.4. The ACO shall issue a final decision within the following statutory time limitations. See FAR 33.211(c) (Reference (ag)).

3.2.7.4.1. For claims of \$100,000 or less, 60 days after receiving a written request from the contractor that a decision be rendered within 60 days, or within a reasonable time after receipt of the written request or claim.

3.2.7.4.2. For claims over \$100,000, 60 days after receiving a certified claim. If the ACO determined that the final decision cannot be issued within 60 days, the ACO shall notify the contractor within 60 days, of the date the decision will be issued.

3.2.7.5. If the ACO will not be able to render a decision within 60 days, then the ACO shall:

3.2.7.5.1. Immediately establish target dates for required actions to support the final decision (e.g., additional inputs from DCAA, required legal counsel reviews) and the target date for making the decision and provide the schedule to the CMO Contracts Director, or Director of Corporate/Divisional Administrative Contracting Officer Group, as applicable.

3.2.7.5.2. Obtain management review of the target schedule (to ensure the schedule meets the statutory timelines) from the applicable CMO Contracts Director or Director of Corporate/Divisional Administrative Contracting Officer Group.

3.2.7.5.3. As required by FAR 33.211(c)(2) (Reference (ah)), provide the contractor a written notification (within the 60 day time period) of the time within which a decision will be issued.

3.2.7.6. Prior to reaching a settlement with the contractor, or releasing a withdrawal notice or issuing a final decision to the contractor, the ACO shall take the following steps.

3.2.7.6.1. The ACO shall document, in a MFR for the contract file, an affirmative statement that the ACO agreed or disagreed with each audit finding and recommendation and sound rationale for resolving each audit finding and recommendation. The rationale must demonstrate that the ACO has considered all appropriate FAR, DFARS, and DCMA Instructions related to the issues raised or questioned by DCAA. Additionally, the ACO shall document, in the MFR, the date of discovery of the unallowable cost.

3.2.7.6.2. The ACO shall obtain management review from the CMO Contracts Director, and any required BoR (DCMA-INST 134, Reference (h)), before issuing a withdrawal notice, negotiating a settlement, or making a final decision. CACOs and DACOs shall obtain management review by the Director of Corporate/Divisional Administrative Contracting Officer Group, and any required BoR (DCMA-INST 134, Reference (h)), before issuing a withdrawal notice, negotiating a settlement, or making a final decision. If this action is delegated, the CMO Contracts Director must delegate to a level no lower than the contract team supervisor/leader.

3.2.7.6.3. The ACO and the CMO Contracts Director, or Director of Corporate/Divisional Administrative Contracting Officer Group, shall ensure that, in preparing the contracting officer final decision, advice is obtained from assigned legal counsel, the Contract Disputes Resolution Center (CDRC) and other advisors in accordance with DCMA-INST 905 (Reference (l)) policy.

3.2.8. When DCAA issues a DCAA Form 1, and the contractor does not object, the ACO need not take further action unless the contractor has overbilled on a contract with no future billings under the contract. In such instances, the ACO shall take steps to recoup the disapproved costs (e.g., issue a demand for payment or disapprove costs under another contract as an offset). In regards to recovery of contract costs, see the policies of DCMA-INST 104 "Contract Debts" (Reference (ai)) and DCMA-INST 905 (Reference (l)) policy.

3.2.9. The ACO shall not take any action to allow the contractor to be paid for some or all costs suspended or disallowed by DCAA prior to withdrawing the notice, negotiating a settlement, or issuing the final decision.

3.2.10. The ACO shall maintain copies of all final versions of DCAA Form 1s, audit reports, MFRs, written communications, legal advice, management review documents, written notices, and final decision documents as stated or implied elsewhere in this Instruction. Additionally, the ACO shall make sure that all these records are maintained in accordance with DCMA-INST 809 (Reference (k)).

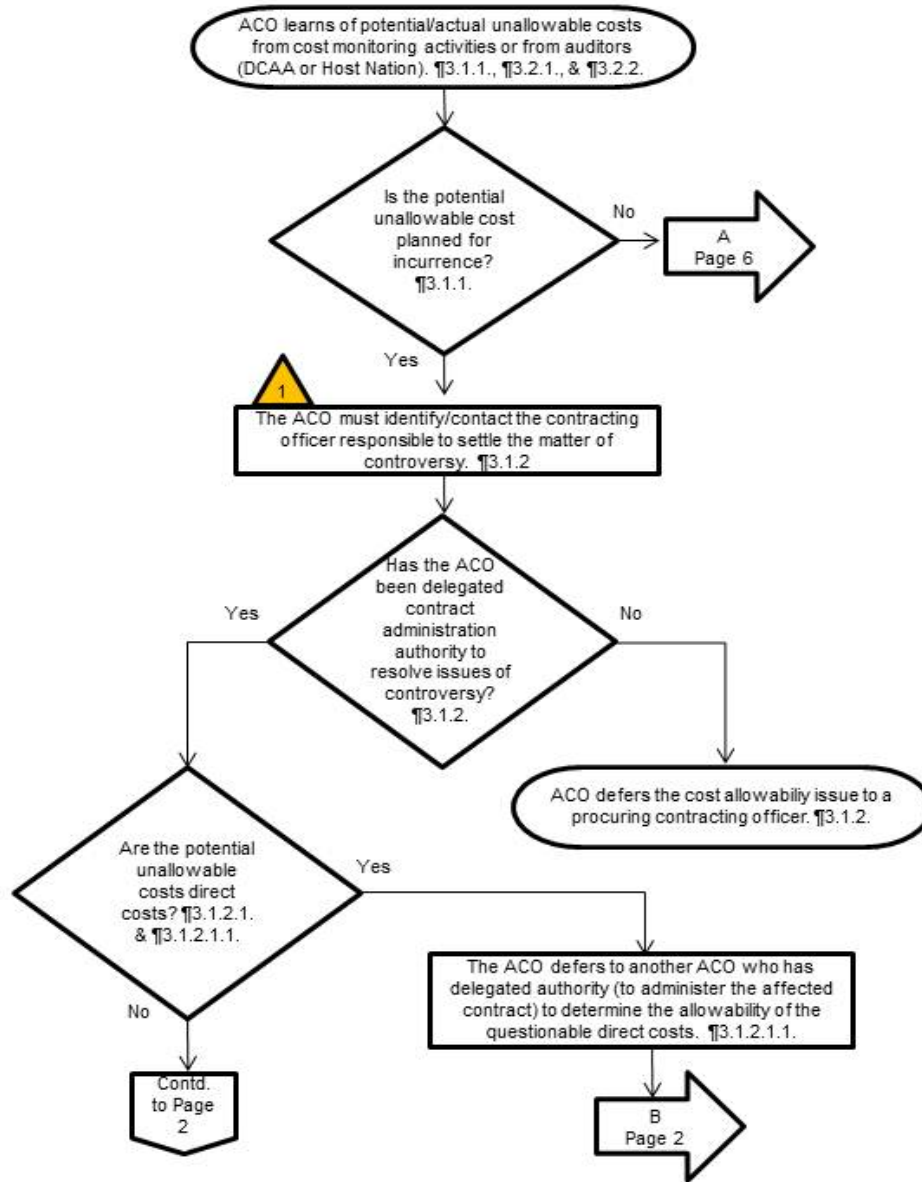
3.2.11. DCMA maintains a Form 1 Tracking eTool that must be an integral part of the cost disallowance process where unallowable costs have been incurred. (**NOTE:** Contract security matters may result in some exceptions for using the Form 1 Tracking eTool. This can occur if a DCMA customer's classification guide or a contract classification guide restricts where contract related information can be stored.) The Form 1 Tracking eTool provides users with an automated process and a central repository for all DCAA Form 1s issued. This eTool serves as an automated way to create, review, approve, and track DCAA Form 1s.


3.2.11.1. Regardless of who initiates a DCAA Form 1, and to the extent other guidance or contract requirements regarding security matters do not conflict, DCAA auditors or ACOs are required to use the DCMA Form 1 Tracking eTool in the process from creation to resolution of a DCAA Form 1.

3.2.11.2. A link to the DCMA Form 1 Tracking eTool, as well as guidance on how to use this eTool, can be found at the resource page associated with this Disallowance of Costs Instruction.

APPENDIX A

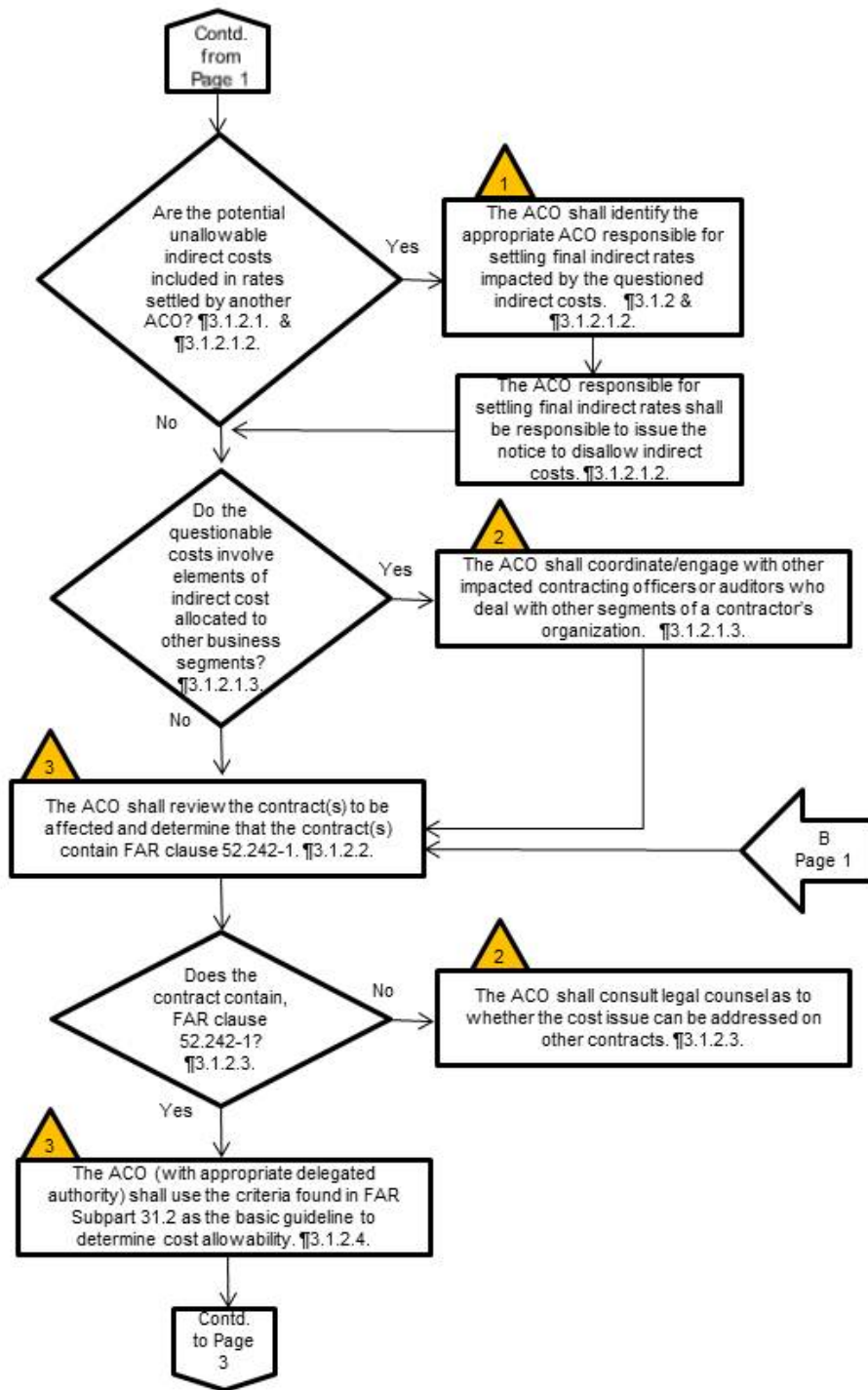
Disallowance of Cost Process Flowchart



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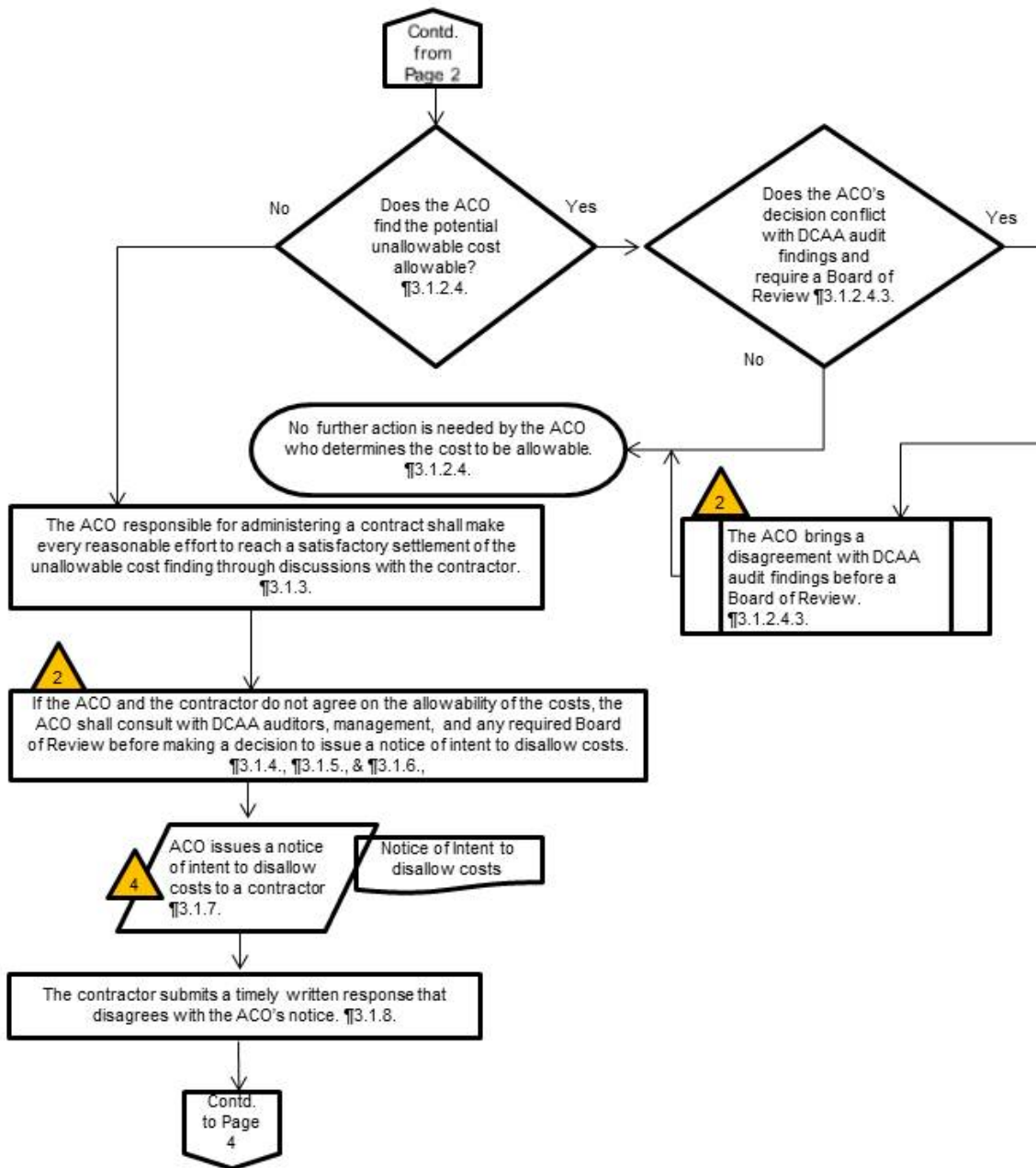
Flowchart
Page 1

Disallowance of Cost Process Flowchart



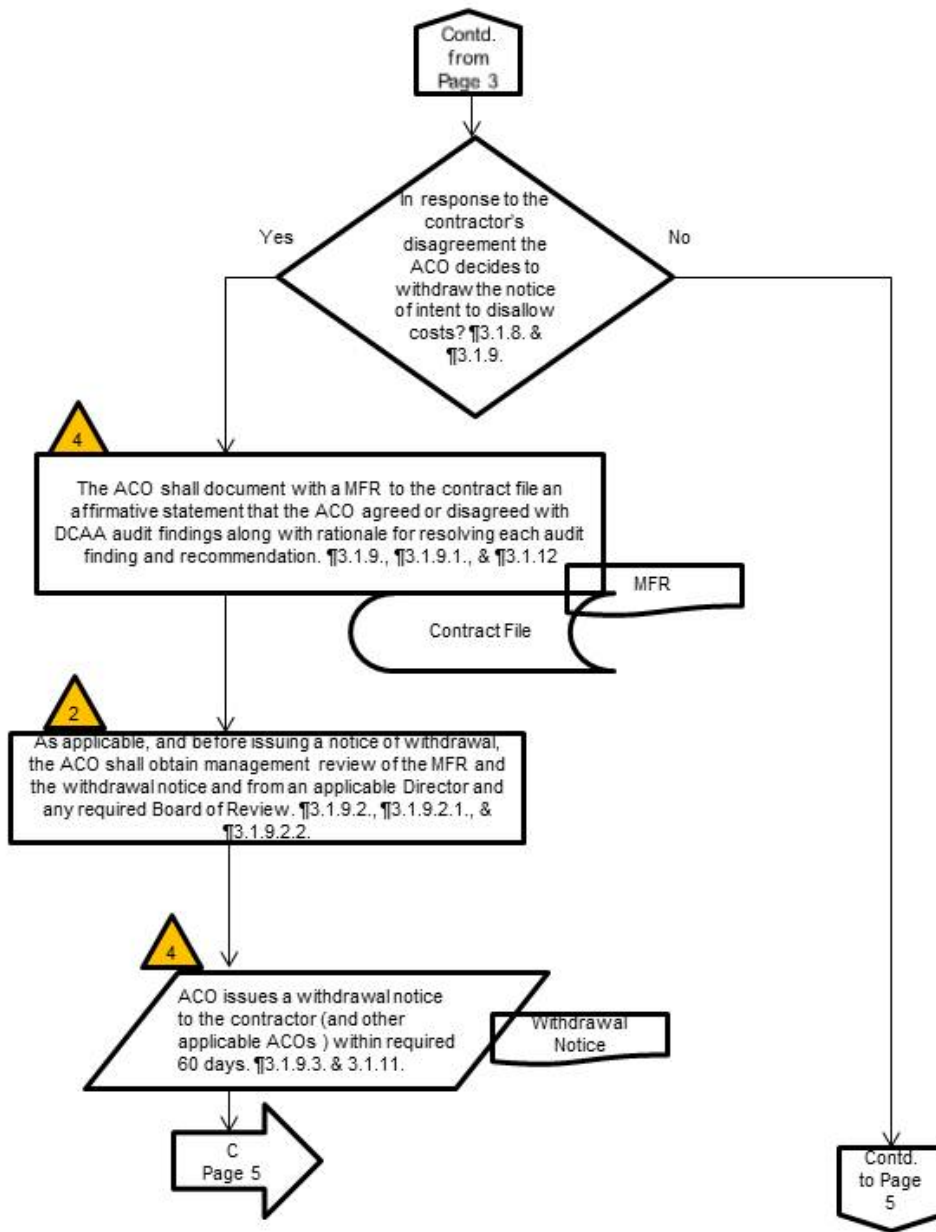
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Disallowance of Cost Process Flowchart



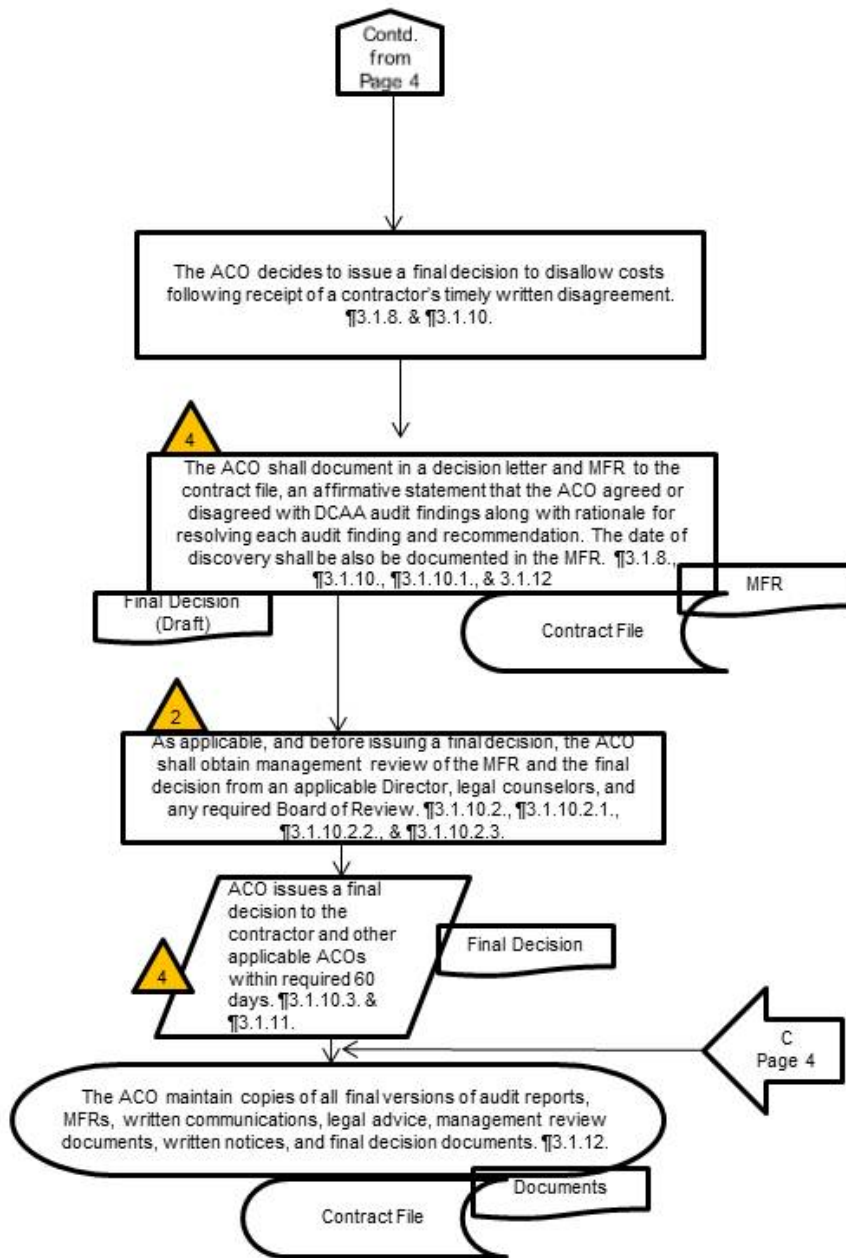
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Disallowance of Cost Process Flowchart



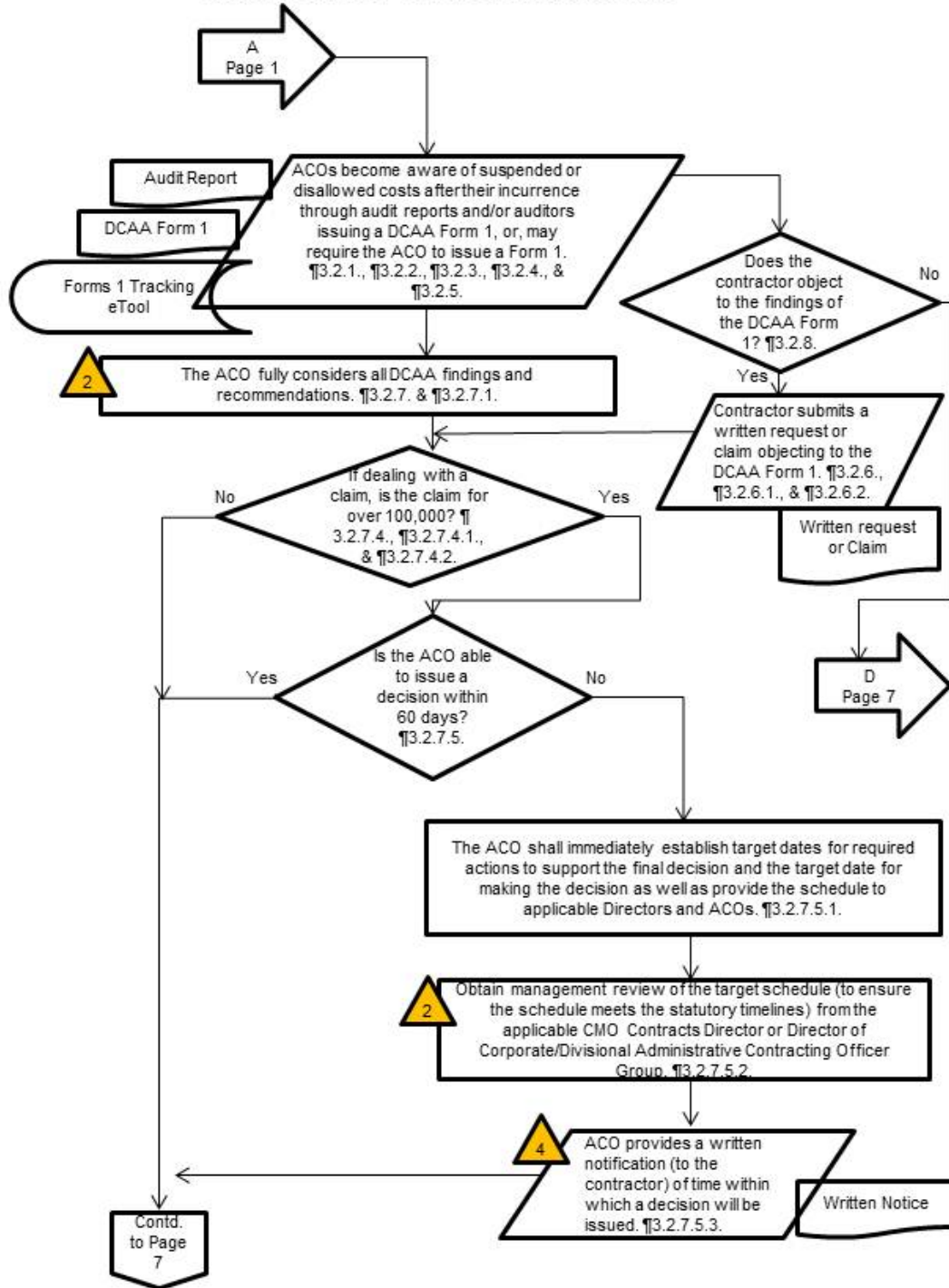
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Disallowance of Cost Process Flowchart



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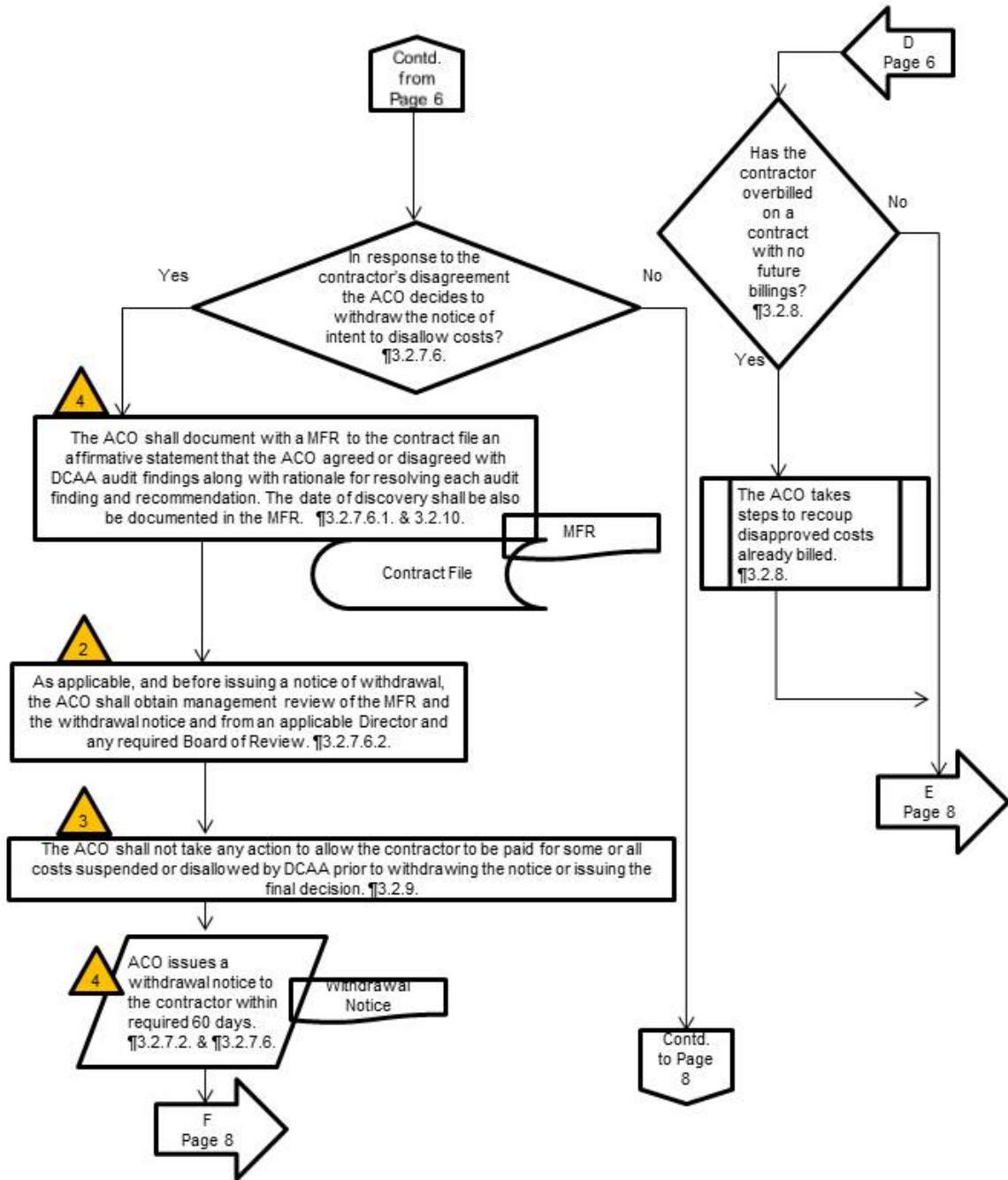
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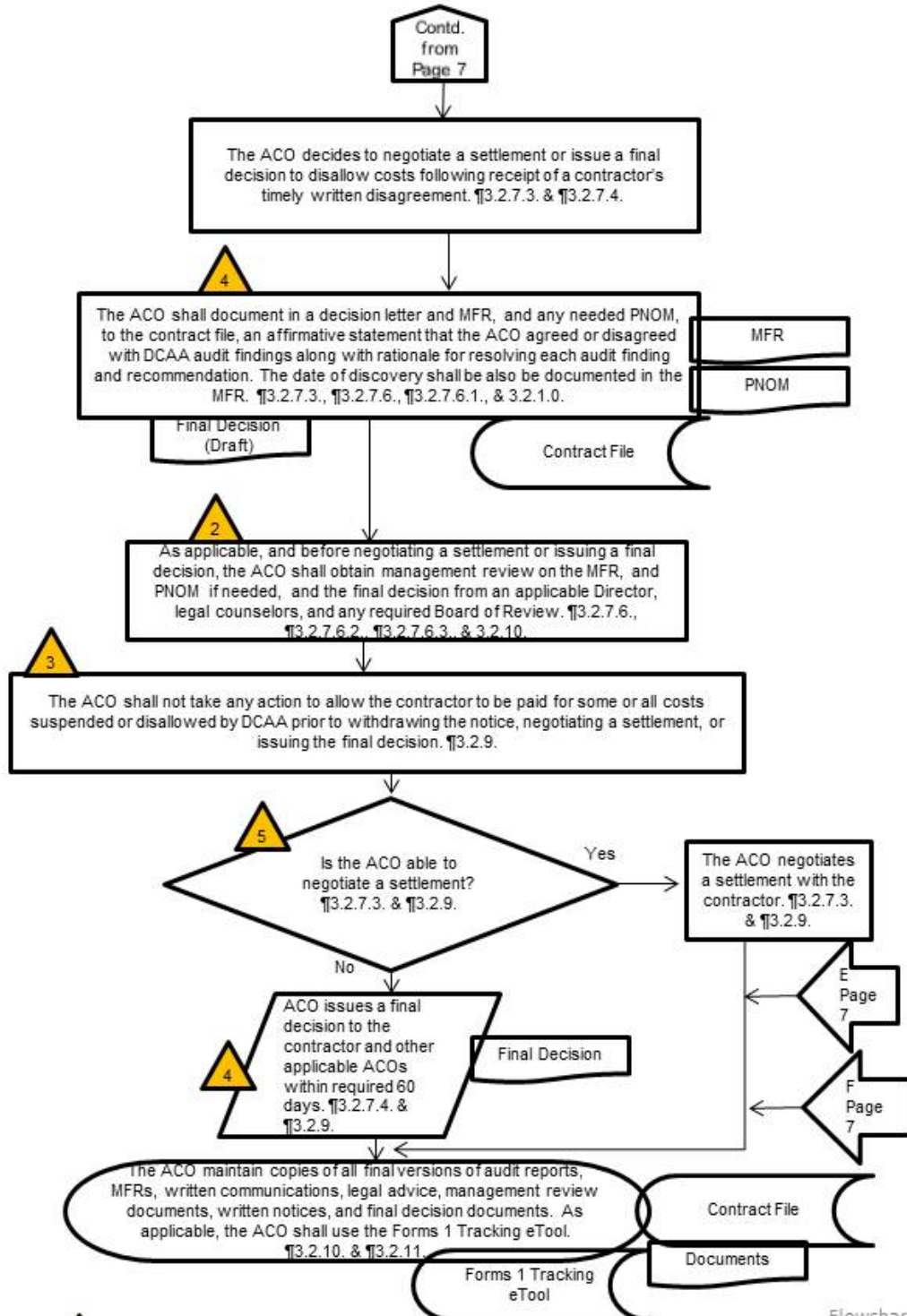
Flowchart
Page 6

Disallowance of Cost Process Flowchart



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Disallowance of Cost Process Flowchart



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Flowchart
Page 8

Key Control Chart of Identified Process Risk			
Key Control	Functional Area	Risk	Possible Controls
1	Communication	Delayed or omitted communications could create statutory time problem	ACO is required to identify/contact the contracting officer responsible to settle the matter of controversy
2	Consultation	<p>Failure to consult with and provide information to other contracting officers or auditors could lead to inaccurate decision</p> <p>Failure to consult with legal counsel may prevent the ACO from pursuing recovery of costs through available options</p> <p>Failure to consult a Board of Review could result in inaccurate decision on unallowable cost(s)</p> <p>Failure to consult with management could result in inaccurate decision on unallowable cost(s)</p>	<p>ACO is required to consult with applicable contracting officers and/or auditors</p> <p>ACO is required to consult with applicable legal counsel</p> <p>ACO is required to consult with applicable Board of Review</p> <p>ACO is required to consult with applicable management</p>

Key Control Chart of Identified Process Risk			
Key Control	Functional Area	Risk	Possible Controls
3	Compliance	<p>Failure of ACO review may result in non-compliance with published policy and contract clause</p> <p>Failure of ACO to review published guidance may result in non-compliance with FAR 31</p> <p>ACO allows a contractor to bill disputed costs without a settlement or ACO decision and this later requires more resources to correct</p>	<p>ACO is required to review contracts to see if they are affected and contain FAR clause 52.242-1</p> <p>ACO is required to review FAR subpart 31.2 as a guideline to determine cost allowability</p> <p>ACO is required to refrain from premature or improper action</p>
4	Documentation	<p>Failure to ensure all required documentation is completed and issued could result in unallowable costs being billed and more resources used for correction</p> <p>Failure to document all prior facts, consultation, and rationale behind a decision could result in the ACO being unable to readily justify a decision</p>	<p>ACO is required to issue applicable documentation (e.g., notice of intent to disallow costs, withdrawal notice, written notice of planned decision date, or final decision)</p> <p>ACO is required to prepare applicable documentation (e.g., MFR or PNOM)</p>

Key Control Chart of Identified Process Risk			
Key Control	Functional Area	Risk	Possible Controls
5	Negotiation	Failure by the ACO to attempt a negotiated settlement may result in the use of government resources to settle a legal dispute that could have been avoided	ACO is required to attempt a negotiated settlement

GLOSSARY

DEFINITIONS

DCAA Form 1 Disapproved Costs. Costs disallowed by DCAA in a DCAA Form 1 where DCAA auditors have completed audit action and believe the disallowed costs are unallowable according to: FAR 31 cost principles (Reference (ae)), contract terms, or a prior determination by an ACO (Reference (ad)).

DCAA Form 1 Suspended Costs. Costs suspended by DCAA in a DCAA Form 1 where DCAA auditors find a cost item (whether direct or indirect) is not supported by adequate explanation or documentary support from the contractor. The costs are suspended from repayment until the contractor provides adequate data to support the the allowability of the cost item (Reference (ad)).

Direct Costs. As defined in FAR 2.101 (Reference (aj)), “ ‘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. The phrase “directly associated costs” is used in FAR 31.201-6 (Reference (z)) in conjunction with unallowable costs is described as, “A directly associated cost is 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.”

Indirect Costs. As defined in FAR 2.101 (Reference (aj)), “ ‘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.”

Unallowable Costs. As defined in FAR 2.101 (Reference (aj)), “ ‘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

ACAT	acquisition category
ACO	administrative contracting officer
BoR	Boards of Review
CACO	corporate administrative contracting officer
CDRC	Contract Disputes Resolution Center
CMO	contract management office
DACO	divisional administrative contracting officer
DCAA	Defense Contract Audit Agency
DCMA-INST	DCMA Instruction
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Services
FAR	Federal Acquisition Regulation
MFR	memorandum for record
OPR	office of primary responsibility
PLAS	Performance Labor Accounting System
PNOM	Pre-negotiation Objective Memorandum