

We previously [shared](#) our thoughts regarding DCAA's June 4, 2010 audit guidance found in Memorandum for Regional Directors (MRD)

[10-PSP-018\(R\)](#)

. In that MRD, auditors were directed to disclaim any opinion on any indirect rates found in a contractor's cost proposal (which DCAA calls "forward pricing rates") where those rates had not yet been audited by the agency.

Where those rates were based on a negotiated Forward Pricing Rate Agreement ([FPRA](#)

) with the DCMA. DCAA should not accept the FPRA rates until auditors had completed "detailed testing" and other "analytical procedures" in order to be able to opine on them. Where FPRA rates had been audited, but the DCMA Administrative Contracting Officer negotiated differing indirect cost rates with the contractor, then the DCAA auditor may accept them. However, where the auditor "believes the ACO did not fully consider the DCAA audit results and there are significant differences between the DCAA recommended rates and the FPRA or FPRR," then the auditor should elevate the disagreement pursuant to the DCAA/DCMA

[dispute resolution process](#)

."

And "If the pricing proposal audit report must be issued prior to resolving this disagreement, the audit opinion should reflect the DCAA recommended rates." In other words, the audit guidance directed the DCAA auditor to substitute his/her judgment for that of the DOD representative who has the authority to bind the government.

** Insert eye roll here**

Suffice it to say that we were *less than enamored* of that piece of audit guidance.

But we are a bit happier with the DCAA's latest MRD, [10-PSP-021\(R\)](#), issued on August 24, 2010, which "clarifies" the previous "guidance on the expectations regarding the contractors' use and extent of budgetary data in support of forward pricing rates." We'll provide some quoted bits from that MRD—

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Contractors must indicate how they computed and applied their indirect rates while also showing trends and budgetary data with explanations to support the reasonableness of the rates per the requirements of FAR Part 15. The extent of detail will vary depending on the specific data supporting each Fiscal Year and based on the size and complexity of the contractor.

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When auditing proposed indirect rates, auditors should perform substantive procedures to evaluate the reasonableness of the contractor's basis of estimate (e.g., budgetary data and historical costs/trends). When historical contractor data is used to support the basis of estimate, the auditor must document the substantive audit procedures performed (previously or currently) to ensure the historical data is in reasonable compliance with FAR Part 31.

Well, that doesn't seem too bad, does it? But that's not all. The MRD contained some—shall we say *aggressive?*—bits as well.

The audit guidance opined that the "overarching principal of FAR Part 15" [sic] is that "the contracting officer must purchase supplies and services at fair and reasonable prices." That's more or less correct, but then the audit guidance states, "Contractors are generally required to follow the Table 15-2 instructions for submitting proposals as contained within FAR 15.408." Well, that's not true *at all*

. Contractors are only required to follow the proposal format instructions found in FAR Table 15-2 when they are submitting cost or pricing data. (Or, if you will, “certified” cost or pricing data, based on the [recently revised](#) FAR definition(s).) If the contractor is not submitting cost or pricing data, it is not required to follow the format of Table 15-2.

(Now there may be some room for controversy here. If you follow the link above to the article, you would see that the phrase “information other than [certified] cost or pricing data” has been redefined to encompass “the identical types of data as certified cost or pricing data, consistent with Table 15–2 of 15.408, but without the certification.” That phrase strikes us as patently ambiguous, but we bet DCAA will seize on it as requiring that all cost information be submitted in the format of Table 15-2—which we would argue would be an incorrect reading of the requirements.)

Anyway, back to the MRD.

After declaring that contractors are “generally required” to follow the format and instructions of Table 15-2, the DCAA audit guidance then stated that Table 15-2 requires contractors to “indicate how they computed and applied indirect rates while also showing trends and budgetary data with appropriate explanations to support the reasonableness of the proposed rates.” The MRD used this as a foundation to state—

Therefore, in accordance with FAR Part 15, a contractor’s indirect rates should be based on a well-supported basis of estimate for each Fiscal Year of the proposed period of contract performance. To demonstrate reasonableness, contractors must show how they computed and applied the indirect rates while also providing supporting trend and budgetary data with appropriate explanations commensurate with the size and complexity of the contractor’s organization. The contractor’s proposal should be prepared in accordance with the contract cost principles and procedures in FAR Part 31 and, when

applicable, the requirements and procedures in 48 CFR Chapter 99, *Cost Accounting Standards* (see requirements of FAR 15.404-1(c)(2)(iv)).

There's more. The audit guidance stated—

At larger contractors it would be expected that the proposed indirect rates for the first year be based on a detailed management-approved operating budget, and each subsequent period be based on adjustments to the operating budget based on strategic or long-range forecasts (e.g., plant expansions, expected business volume, etc.). At a large contractor, with a board of directors, one would expect detailed budgets and forecasts to be in place to provide the directors with knowledge of future planned capital expenditures and other strategic and long range objectives. The contractor's proposed rates should be consistent with this budgetary data.

Now, we all know that there is almost no chance that any contractor, large or small, has detailed operating plans that project out for any great length of time. Although some of the language above seems to expect a "well-supported estimate for each Fiscal Year of the proposed period of contract performance," other parts seem to be more forgiving, stating that only the first year needs to be supported with a "detailed management-approved operating budget" and that subsequent periods can be based on "adjustments" to that first year budget "based on strategic or long-range forecasts."

That seems fairly reasonable, assuming somebody has made those "strategic or long-range forecasts" and has shared them with those people calculating the forward pricing rates used in cost proposals. As the MRD stated, "Generally, the level of forecasted detail will decrease as the period being estimated moves further into the future and the uncertainty of conditions and potential events grows. Therefore, it is not expected that even larger contractors prepare detailed operating budgets for each Fiscal Year of contract performance...." Seems okay, right?

But wait a second. Let's look a bit deeper at the MRD. It stated—

The FAR requires an explanation of how the rates were derived for each of the out-years to allow the contracting officer to ascertain the reasonableness of the rates. For example, flat-lining out-year rates with no explanation to support that the rates will not change in future periods is not adequate. Adjustments to out-year pools and bases should be made based on reasonable sales forecasts and the contractor's assumptions for changes to major groupings of costs (e.g., variable, semi-variable, and fixed). In addition, for multi-segment contractor organizations the budgets and forecasts should reconcile for all significant cost allocations and interdivisional effort supporting the proposed rates.

We would be shocked if the large multi-segment contractors ensured that their out-years' rates were based on budgetary data that reconciled for "all significant cost allocations and interdivisional effort." That's simply a huge amount of effort—nearly impossible within any reasonable timeline.

Although the audit guidance told DCAA auditors that "the extent of data supporting a contractor's proposed indirect rates will vary," the standards it applied to the largest contractors would be extremely difficult to meet. What happens if a contractor can't satisfy the auditor that its forward pricing rates are well-supported and based on budgetary data?

In such cases, the MRD stated—

As outlined in CAM 9-205(d), if the contractor's indirect rate forecasts are not adequately supported throughout the entire period of performance and are so deficient that an examination of the unsupported years cannot be performed, the auditor should recommend that the contracting officer return the proposal to the contractor.

We opined in our previous article that DCAA's recent audit guidance was tantamount to throwing a monkey wrench into the gears of the DOD acquisition machinery. While there are a few nuggets of goodness in this latest MRD, our opinion is that there also much in it that we believe supports our previous opinion. We understand the audit agency's need for independence—but if this is the price we have to pay for independence, then we urge the Pentagon to figure out another way of getting contractor proposals evaluated so that the parties can negotiate a reasonable price.