



**Department of Energy
Acquisition Regulation**

No. AL -2008-02
Date 07/25/08

ACQUISITION LETTER

This Acquisition Letter is issued under the authority of the DOE and NNSA Procurement Executives.

Subject: **Audit Management**

References:

FAR Part 7	Acquisition Planning
FAR Part 15	Contracting by Negotiation
FAR Part 30	Cost Accounting Standards Administration
FAR Part 31	Contract Cost Principles and Procedures
FAR Part 42	Contract Administration and Audit Services
FAR Part 44	Subcontracting Policies and Procedures
FAR Part 49	Termination of Contracts
DEAR 915.404-2-70	Audit as an aid in proposal analysis
Acquisition Guide	Chapter 7, Acquisition Planning
Acquisition Guide	Chapter 37, Service Contracting
Acquisition Guide	Chapter 42, Contract Administration
Acquisition Guide	Chapter 42.1, Indirect Cost Rate Administration
OMB Circular A-21	Cost Principles for Educational Institutions
OMB Circular A-50	Audit followup
OMB Circular A-87	Cost Principles for State, Local and Indian Tribal Governments
OMB Circular A-122	Cost Principles for Nonprofit Organizations
OMB Circular A-133	Audits of States, Local Governments, and Non-Profit Organizations
DCAAM 7640.1	DCAA Contract Audit Manual
NNSA BOP-003.0404	Requests to DCAA for Audit of M&O Contractor Subcontracts

When is this Acquisition Letter (AL) Effective?

This AL is effective upon issuance.

When Does this AL Expire?

This AL remains in effect until superseded or canceled. It replaces AL 2006-12, which remains available in Acquisition Letter Archives on the Office of Procurement and Assistance Management homepage.

Who is the Point-of-Contact?

For DOE, contact Helen Oxberger at (202) 287-1332 or by e-mail at helen.oxberger@hq.doe.gov. For NNSA, contact either Jill Robbins at (202) 586-9678 or via e-mail at jill.robbsins@nnsa.doe.gov in the Office of Acquisition and Supply Management; or Dan O. Romero at (505) 845-6982 or by e-mail doromero@doeal.gov in the NNSA Service Center, Office of Business Services.

Visit the website at

http://www.management.energy.gov/policy_guidance/procurement_acquisition.htm for additional information on Acquisition Letters and other policy issues.

What is the Purpose of This AL?

The purpose of this AL is to provide guidance to contracting officers (CO) on planning audits for other than management and operating (M&O) contracts. M&O contract audits are covered by Department of Energy Acquisition Regulation (DEAR) 970.5232-3, Accounts, records, and inspection, Chapter 4 of the Accounting Handbook, and Chapter 18 of the Inspector General (IG) Audit Manual. For the purpose of this AL, references to DOE include the National Nuclear Security Administration (NNSA).

What is the Background Information?

Audits for Contracts

The Department transfers over \$15 million each year to audit service providers, through the Intra-governmental Payment and Collection (IPAC) System, using four Headquarters administered interagency agreements (IAs). Audit services may be obtained for subcontracts under M&O contracts as well as for non-M&O prime contracts. The Office of Inspector General (OIG) has audit cognizance for prime M&O contracts through the use of the Cooperative Audit Strategy Program (see Acquisition Guide Chapter 70.4). The Department of Health and Human Services (HHS), the Office of Naval Research (ONR), and the Defense Contract Audit Agency (DCAA), may have audit cognizance for other than DOE M&O prime contracts.

Audits for Financial Assistance

While pre- and post award audits are neither required nor normally obtained for financial assistance awards, they may be helpful in the review and approval of a budget. Therefore, audits should be considered for high dollar value awards, for high risk recipients with poor financial management systems, or when other risk factors exist. Authorized audits for financial assistance awards are performed by HHS or ONR. The DOE OIG is also an authorized audit entity for some financial assistance recipients. Audit assistance may be appropriate for determining indirect rates.

OMB Circular A-133 requires universities, state and local governments and non-profits to have a single audit performed by an independent auditor for each fiscal year in which \$500,000 or more

is expended from all federal funds received by the entity. For-profit companies are also required to have a similar type of audit performed in accordance with 10 CFR 600.316. Audit assistance may be necessary to evaluate single audits with qualified opinions and associated corrective action plans.

What is the Guidance Provided in This AL?

I. *Who are the Audit Service Providers for DOE?*

The audit service providers for DOE are the DCAA, HHS and ONR. The CO can avoid duplication of costs and time by first using the audit services of the assigned cognizant audit agency for a particular entity. OMB Circular A-87 provides HHS with audit cognizance for coordinating audits and negotiating indirect cost rates for non-profit, state, local government organizations, and universities and colleges. OMB Circular A-21 (relocated to 2 CFR Part 220) provides ONR with audit cognizance for contract administration services for the university research community. For all other business entities, DCAA offers a variety of services in addition to audit support; such as, rate verification and partial audit. Historically, DCAA has been the predominant provider of contract audit services for the DOE.

DOE Office of Engineering and Construction Management (OECM) is the primary organization that performs certification of a contractor's earned value management system (EVMS) in accordance with DOE Order 413.3A, Program and Project Management for the Acquisition of Capital Assets, for any cost reimbursement contracts exceeding \$50 million. EVMS certification of contractors for the DOE was provided previously by Defense Contract Management Agency (DCMA).

It is the policy of the Department to follow the Single Audit Act of 1984, which requires the utilization of the cognizant audit agency to avoid the duplication of audit effort and to prevent the misuse of program funds for audits. See OMB Circular A-133, for policies, regulations and procedures regarding compliance with the Single Audit Act of 1984 and its subsequent amendments.

II. *What Should the Contracting Officer (CO) Consider Before Requesting a Contract Audit?*

According to FAR 15.404-2, the CO should request field pricing assistance when the information available at the buying activity is inadequate to determine a fair and reasonable price. The CO must tailor requests to reflect the minimum essential supplementary information needed to make this determination.

A. *Timing of the Audit*

A key step when planning a proposal evaluation is to determine the level of audit agency support necessary to complete a thorough evaluation. Essential considerations are the contract timeline, (i.e., prior to or after contract award) and

identifying any products and services needed from the audit service provider. Each of the terms used below have a specific meaning to the audit agency.

Pre-award. In the preaward phase, audits are primarily requested by the CO. Services available vary from reviews of full proposals and/or rates, rate verification, partial proposed reviews, and agreed-upon-procedures. Other services include financial capability determinations, evaluating contractor estimating systems, evaluating contractor initial price proposals, evaluating initial disclosure statements, and supporting negotiations.

Post award. Contract audit services covered under this phase are contractually required or requested by the CO. Examples include reviews of provisional billing rates (PBRs), audits of final indirect rate proposals for establishment of final indirect rates, requests for equitable adjustments, progress payments, and EVMS. Additional services may include reviews of forward pricing rate agreements (FPRAs); termination settlement proposals; cost accounting standards (CAS) disclosure statement adequacy determinations or CAS compliance. Contractually required reviews include audits of contractor internal financial systems, incurred cost, estimating system surveys, post award audit, and post award accounting surveys.

B. Type of Procurement

There are many factors to consider when determining the extent of audit support required. They include the type of procurement (e.g., development versus commercial-off-the-shelf (COTS) supplies/equipment), size, complexity, total cost, subcontracting, and CAS implications.

■ Procurement Size and Complexity

- What is the dollar value?
- Is this a major acquisition?
- What is the complexity level of the program?
- What is the previous experience of the offeror/contractor? Is this a new firm or new product or service area for the firm?
- What is the past performance record of the offeror?
- How adequate is the financial information submitted by the offeror? For example, are these audited annual reports?
- Does a proposal with certified cost or pricing data meet the minimum dollar threshold for audits required by DEAR 915.404-2-70?
- Is this a large procurement or a large contract award for the firm?

- **Subcontracting**

- Is there a substantial subcontracted cost included in the proposal's total price?
- Is the number of subcontractors significant?
- What is the magnitude of total subcontracted costs in relation to the prime contract?

- **CAS Considerations**

- Are there any outstanding CAS non-compliances affecting the proposal (FAR 30.601(b); and FAR 52.230-6 for subcontracts)?
- Other information on the specific contractor (e.g., prior audit reports, historical data, other pertinent DOE contracts on same or similar efforts, FPRAs, etc.).
- Regulatory requirements: FAR Part 42 and OMB Circular A-133 require certain awards to be audited. FAR requires that indirect rate submission from for-profit entities be audited. OMB Circular A-133 does not provide an allowance for waiver of post award audit if the award is over a certain dollar threshold.
- NNSA Policy Letter BOP-003-0405, documents NNSA Service Center issuance of an annual call on or about August 1st to Site Offices to assess DCAA support needs for the forthcoming fiscal year, with responses in the required format.

C. Other Considerations

Always review and consider other information available on the specific contractor or an offeror before ordering an audit. Below are examples of questions you should consider in making your decision.

- **Pre-Award Procurements**

- Do I have audit reports from recent proposal reviews on the specific offeror?
- Do I have unresolved questionable areas and non-compliance issues in the previous audit reports?
- Do I have the offeror's actual contract costs on previous contracts to compare to the prices proposed?
- Can I verify the proposed labor rates based on information already available?
- Do I have recent FPR proposals, recommendations, or agreements on the offeror?
- Is available data adequate for determining the reasonableness of the offeror's proposed price?
- Is the offeror's estimating, accounting, or purchasing methods reliable?
- Do adverse audit findings disclose significant internal control problems and/or unresolved questioned costs?
- Is the government unable to make price reasonableness determination because of:
 - Lack of knowledge of the particular contractor?
 - Risk factors identified that may require technical assistance from the program office; or
 - Inadequacy of existing information.

- **Post Award Procurements**

- Are invoiced costs allowable, reasonable, and allocable?
- Do I have final negotiated indirect rates as established by the cognizant federal agency (CFA), cognizant designated office (CDO), or CO to generate the cost claims by the contractor?
- Do I have the proper incurred cost rates for final contract closeouts?

III. When Should I Request Rate Verification, Versus a Partial Audit, or a Full Audit?

Depending upon the factors discussed above, the CO must determine if a full or partial audit or rate verification is sufficient to determine price reasonableness. The CO may request the development of recommended rates for applicable labor categories and corresponding indirect rates if the procurement simply involves services.

Rate verification for preaward action is not as extensive as an audit, but the audit service provider can ensure that the rates proposed are reasonable. Rate verification consists of the audit service provider determining whether proposed rates are consistent with

previously approved or recommended provisional rates. Rate verifications can be performed quickly and are useful when the contractor has had previous dealings with the Government and there has not been any significant change in the contractor rates. DCAA does not charge DOE directly for this service.

A partial audit is a review of contractor's rates, including examining indirect pools, cost bases, and direct labor rates. The audit involves portions of the proposal that may have been covered by other audits or previously requested PBRs.

A full audit involves a review of contractor costs including the rates reflecting those costs in accordance with the criteria established by generally accepted government auditing standards (GAGAS). For indirect costs this entails a review of indirect pool rates and associated bases, (e.g., direct labor rates). An audit may be necessary when the contractor has no prior or recent dealings with the government or there has been a significant change in contractor rates. A full audit is also necessary for post-award closeout under cost type contracts and certain non-profit entities, unless quick close-out procedure is used or formally waived by the CO. In this circumstance a close-out audit or some form of financial reconciliation is still required. An audit provides a more complete review of costs than rate verification. An audit is also used when rate verification will not provide sufficient support in analyzing the contractor's proposal.

DCAA also performs contract audits limited to agreed-upon-procedures, such as a tailored review of a specific area or cost element of a proposal, a review for cost realism, or an evaluation factor. Another DCAA service is an audit follow-up, where DCAA reviews specific contractor rates at a specified later date. All these services are included as an additional cost to the original audit.

IV. Cognizant Federal Agency (CFA)

As defined by FAR 2.101, "a cognizant Federal agency means the Federal agency that, on behalf of all Federal agencies, is responsible for establishing final indirect cost rates and forward pricing indirect rates, if applicable, and administering cost accounting standards for all contracts in a business unit. The CFA is responsible for performing a designated function on behalf of all Federal agencies, such as the establishment of indirect cost rates and indirect cost determinations."

The assignment of CFA responsibility for any given contractor is based on which federal agency has awarded the predominance of the contractor's contract dollars. If DOE is the CFA, the CO should (1) ensure that FPRAs are established; (2) establish and track contractor PBRs and final indirect cost rate proposals; (3) request advisory audit services when deemed appropriate; and (4) establish pre-negotiation objectives and negotiate settlement of annual incurred costs and indirect rates. The CO should ensure that the contractor's or offeror's proposed rates are properly applied.

If DOE is not the CFA, the DOE CO should coordinate with the CFA to obtain or establish PBRs to be used by DOE non-M&O contractors, coordinate with the CFA to obtain or establish forward pricing indirect rates, monitor DOE contracts managed by other agencies as the CFA, and obtain and review all applicable audit reports and agreement letters issued by the CFA. The DOE CO should receive the same rates used by the CFA for a given contractor unless the contract/financial assistance award in question has a specific advanced agreement that renders a different indirect rate than normally allowed by the appropriate cost principles. These instances may require the CO to re-negotiate the indirect rate specific to a particular award/contract. DOE COs have the authority to withhold payment of indirect costs if current PBRs are not being applied, as approved by the appropriate CFA. See DOE Acquisition Guide Chapter 42.1, Indirect Cost Rate Administration (Dec 2004) for policy, procedures and responsibilities of CFA and CDO.

V. *How are Contract Audit Services Acquired Within DOE?*

In accordance with FAR 42.1, Contract Audit Services, the Department has established interagency agreements (IA) with each audit service provider to obtain contract audit services. DOE has negotiated a corporate Memorandum of Understanding (MOU) with the responsible audit agency to delineate the terms and conditions required to obtain the desired audit services. However, there are instances where a DOE Program may require that a separate audit service agreement be established in order to satisfy a unique need outside of the Department's existing agreements. For example, a Program may require that the responsible audit agency establish an on-site office for a set time period to provide the necessary audit services required at that site. When such unique, separate audit service agreements are determined necessary, through local discussion among the stakeholders, (procurement, legal, budget, program, etc.) and approval by the CO, a single point-of-contact (POC) for the audit services should be established and coordinated with MA-61 in order to avoid potentially duplicative or unnecessary audits, reviews, inspections, and examination of contractor and subcontract records associated with that site and project.

Ordering procedures under DOE's IA and/or MOU provide for local ordering of audit properly allocated. The CO is ultimately responsible for determining the need for and ordering audits.

The DOE POC for audit services in MA-61 has an overall responsibility to ensure sufficient funds are available for the performance of required audit services. In support for these audit services, each DOE program CO that requests audits from any audit service provider may designate a single POC (as determined by local procedure) responsible for tracking his or her audit request. Each program office is responsible for monitoring and coordinating funding requirements for audits in accordance with the DOE Working Capital Fund (WCF) procedures.

Funding for these services is managed under the DOE WCF Program. The WCF obtains funding at the beginning of each fiscal year from each program based on the previous use for these services plus an additional annual escalation. In cases where a program may exceed or underuse its allotted share of funds for the current FY, the funding estimate for the next FY would be adjusted to accommodate the differences.

Where DCAA is the cognizant audit agency, the responsible DCAA audit office is determined based on the level of audit activity and geographical location. Consistent with this practice, DCAA and the DOE POC MA-61 for audit services assign the corresponding DOE Program site an identifying Funding Customer Identification Code (FCID), which tracks billable hours, dollars spent, and other information for a particular DOE Program Office.

VI. How Should the Contracting Officer Ensure Effective Audit Management?

- Use the cognizant audit agency at all times unless special circumstances warrant an exception.
- Through coordination with the cognizant audit agency and the OIG, prevent duplication of effort as required by the Single Audit Act.
- Identify the cognizant CFA and CDO to ensure consistency in using the same rates of a specific contractor; and
- Provide the appropriate supporting information to the cognizant audit agency necessary to conduct an effective audit or rate verification. In order to ensure maximum benefit from these reports, the written request should:
 - describe the support needed;
 - state the specific areas for which input is required from the audit provider;
 - include the information necessary to perform the review (such as the offeror's proposal and the applicable portions of the solicitation, particularly those describing requirements and delivery schedules);
 - assign a realistic deadline for receipt of the report (normally, pre-award audits can be expected to take a minimum of approximately 30 days to perform.); and
 - describe the reason for requesting the audit and include the name, address, and phone number of the contact person at the firm;

- Be specific in what is requested or agreed to in the audit.
- Adhere to the normal audit cycle.
- Work with DCAA to ensure that they receive the final indirect submissions from the audit entity in a timely manner.
- Coordinate with the appropriate CFA and CDO prior to initiating any special audits.
- Be sure to request only audit support in those areas where adequate information is not already available. DCAA typically conducts a follow-up audit, which carries an additional charge with it.
- In order to ensure DCAA reviews meet the CO's requirements, submit the pre/post negotiation memorandums to DCAA to close the audit process with DCAA. The pre/post negotiation memorandums should include the negotiation position, and fully describe the resolution of audit recommendations as described in FAR 15.406-3, and FAR 42.705-1. The documentation should include a summary of the contractor's proposal, and any DCAA, HHS, ONR or other field pricing assistance recommendations. If the CO deviates from the recommendations of the auditor, the memorandum should explain why.