



ACQUISITION LETTER

This Acquisition Letter is issued under the authority of the Senior Procurement Executive of DOE. It is intended for use by procurement professionals of DOE, primarily Contracting Officers, and other officials of DOE that are involved in the acquisition process. Other parties are welcome to its information, but definitive interpretations of its effect on contracts, and related procedures if any, may only be made by DOE Contracting Officers.

Subject: The Office of Inspector General's Audit Strategy

References:

FAR Subpart 42.7—Indirect Cost Rates
DEAR Clause 970.5216-7 Allowable Cost and Payment
FAR Subsection 30.202-6, Responsibilities
FAR Subsection 30.202-7, Determinations
FAR Subpart 30.6—CAS Administration

When is this Acquisition Letter (AL) effective?

This Acquisition Letter (AL) is effective immediately upon issuance.

When does this AL expire?

This AL remains in effect until superseded or canceled.

Who is the intended audience for this AL?

Department of Energy (DOE) Contracting Officers (COs) are the intended audience.

Who is the point of contact?

DOE Contracting Officers should contact MA-611, DOE_oapmpolicy@hq.doe.gov.

For additional information on ALs and other issues, visit our website at:

<http://energy.gov/management/office-management/operational-management/procurement-and-acquisition>

What is the purpose of this AL?

This AL provides general guidance to DOE COs regarding the most significant roles (and their associated responsibilities) of the contractor and of Government officials in the Office of Inspector General's (OIG's) audit strategy for management and operating (M&O) contracts and in the DEAR class deviation issued to support it.

What types of M&O and non-M&O contracts are affected by this AL?

All M&O contracts and other contracts that include DEAR clause 970.5216-7 Allowable Cost and Payment are affected by this AL.

What is the background information?

The OIG replaced its Cooperative Audit Strategy for M&O contracts with an audit strategy

that adopts the Federal Acquisition Regulation (FAR) audit strategy. A class deviation to the DOE Acquisition Regulation (DEAR) was issued to support the OIG's audit strategy. The lynchpin of the class deviation is a new DEAR clause that is essentially the FAR Allowable Cost and Payment clause (the new DEAR clause retains DOE's current practice of making payments under M&O contracts per DEAR 970.5232-2, "Payments and advances"). The new DEAR clause, along with the rest of the class deviation, brings the FAR construct for contract audit into M&O contracts. Consequently, the FAR establishes the roles of the contractor and of Government officials in the OIG's new audit strategy. The most prominent Government officials are the CO, the cognizant Federal agency official (CFAO) responsible for establishing final indirect cost rates, the CFAO for Cost Accounting Standards (CAS) Administration, and the contract auditor.

M&O contracts are cost-reimbursement type contracts. FAR's primary coverage of the subject of post-award audits of cost-reimbursement type contracts is found in FAR Subpart 42.7—Indirect Cost Rates. (FAR uses the term "final indirect cost rate proposal" in its discussion of these types of audits; others sometimes use the term "incurred cost proposal.") Subparagraph (d), "Final indirect cost rates," of the new DEAR clause requires the contractor and the Government to establish the contractor's annual final indirect cost rates per FAR Subpart 42.7.

The efficacy of FAR Subpart 42.7's guidance in ensuring the Government only reimburses allowable costs depends on the guidance in other FAR Parts and Subparts, particularly FAR Part 30—Cost Accounting Standards Administration. The CAS provide the rules for the measurement, assignment, and allocation of Government contract costs for those contracts to which they are applicable. The CAS are significant in determining the allowability of costs: two of the five regulatory requirements for a cost to be allowable are "Allocability" and the "Standards promulgated by the CAS Board, if applicable."

The process of determining the allowability of the costs the contractor includes in its annual final indirect cost rate proposal begins before year end. Long before then, for example, the Government has determined the contractor's accounting system is adequate for use in the contract, the contractor has submitted and obtained approval of its CAS disclosure statement from the CFAO for CAS administration, the CO or the CFAO for determining final indirect cost rates has established billing rates, and the Government (CO, CFAO, and auditor) has performed both routine contract administration activities and routine audit activities (which in some cases has led to ad hoc audits by the contract auditor of particular costs and ad hoc reviews of the contractor's internal controls).

While this AL focuses on significant parts of the contractor's and of Government officials' roles in determining the contractor's annual final indirect cost rates (FAR Subpart 42.7), and necessarily covers in some detail a portion of CAS administration (FAR Part 30), COs should not infer that they (or other Government officials or the contractor) can give short shrift either to other parts of those roles described in FAR Subpart 42.7 and FAR Part 30 or to the guidance in other FAR Parts and Subparts related to those roles. In fact, they must adhere to all elements the FAR prescribes related to determining final indirect cost rates to be confident their efforts will ensure the Government only reimburses allowable costs.

Note that, per the FAR, the CO, the CFAO (or CFAOs), and the auditor have primary responsibilities, which are discussed briefly below.

The CO: (1) is responsible for ensuring performance of all necessary actions for effective contracting, compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships; (2) must consider the advice of specialists in audit, law, etc.; (3) designates CO representatives as appropriate; (4) may delegate the 71 contract administration functions that FAR 42.302 (a) lists to a contract administration office; and (5) may not retain four of the 71 functions—negotiating forward pricing rate agreements, establishing final indirect cost rates, administering CAS, and determining the adequacy of the contractor’s accounting system—unless the agency designates the CO to perform those functions. The CFAO responsible for establishing final indirect cost rates may be, but is not necessarily, the CFAO responsible for CAS administration. (Note: As FAR Subpart 2.1’s definition of “Contracting officer” implies, the establishment of CFAOs does not restrict in any way a CO in the performance of any duty.)

The CFAO for CAS administration performs CAS administration for all contracts and subcontracts in a business unit, which includes making all CAS-related required determinations and findings and requesting and considering the advice of the auditor as appropriate.

The CFAO responsible for establishing final indirect cost rates determines the final indirect cost rates for a business unit of a contractor as well as the unit’s billing rates.

The auditor is responsible for: (1) submitting information and advice to the requesting activity, based on analysis of the contractor’s financial and accounting records or other related data as to the acceptability of the contractor’s incurred and estimated costs; (2) reviewing the financial and accounting aspects of the contractor’s cost control systems; and (3) and performing other analyses and reviews that require access to the contractor’s financial and accounting records supporting proposed and incurred costs.

The following discussion deals with the primary responsibilities of the contractor, the CO, the auditor, and the CFAOs (the CFAO for CAS administration and the CFAO for final indirect cost rates determination). The CFAO responsible for establishing final indirect cost rates may be, but is not necessarily, the CFAO responsible for CAS administration. While the field Office of the Chief Financial Officer (OCFO) generally will have responsibility for CAS administration and normally the CFAO for CAS administration will be an official of the field OCFO, the Heads of Departmental Elements and the Heads of Contracting Activities determine the CFAOs for CAS administration and for final indirect cost rate determination and the extent of their authority. They may elect not to establish a CFAO other than the CO for either function; if they do establish a CFAO that is other than the CO, they may limit the CFAO’s authority to any extent appropriate to the circumstances. After the Heads of Departmental Elements’ and the Heads of Contracting Activities’ determinations (if any) of each CFAO and the CFAO’s authority, COs, to reflect those determinations, should designate each CFAO (if any) in writing, making clear both the extent of the CFAO’s authority and that the designation does not restrict in any way the CO in the performance of any duty.

Also, the following discussion assumes that the contracting activity uses the FAR-recognized traditional practice of the CO’s not retaining the contract administration functions of establishing final indirect cost rates, administering CAS, and determining the adequacy of the

contractor's accounting system. Consequently, where the FAR requires either "the CO or the CFAO" to perform an action, usually only the CFAO is mentioned (in some cases the CO is listed also) and where the FAR requires the action be performed only by the CO, only the CO is mentioned.

CAS Administration

The contractor's role

The contractor must—

- make the required solicitation certifications in responding to a solicitation;
- submit its initial CAS Disclosure Statement to the auditor and to the CFAO for CAS administration;
- if notified, remedy any defects in its submitted initial Statement;
- adhere to its approved accounting practices;
- during the term of the contract, cooperate with both the auditor and the CFAO for CAS administration in, among other things, their
 - determining materiality
 - processing changes to cost accounting practices
 - processing noncompliances
 - resolving cost impacts.

The CO's role

The CO must—

- determine when a proposed contract may require CAS coverage, and if it does include the appropriate notice in the solicitation;
- ensure the offeror makes the required solicitation certifications and submits the required initial Disclosure Statement;
- insert the appropriate CAS clauses in the contract;
- when necessary, assist the CFAO in resolving issues related to the initial Disclosure Statement;
- not award a CAS-covered contract until the CFAO determines the required initial Disclosure Statement is adequate;
- within 30 days after contract award, request the CFAO to perform CAS administration;
- during the term of the contract, when necessary, assist the CFAO in resolving issues related to CAS administration.

The contract auditor's role

The contract auditor must—

- conduct an adequacy review of the contractor's initial CAS Disclosure Statement to ascertain whether it is current, accurate, and complete;
- report the results of the adequacy review of the initial Statement to the CFAO for CAS administration;

- if the CFAO determines the contractor’s initial CAS Disclosure Statement inadequate, and the contractor submits a revised initial Statement, conduct an adequacy review of the revised initial Statement to ascertain whether it is current, accurate, and complete;
- report the results of the adequacy review to the CFAO for CAS administration;
- if the CFAO notifies the auditor the contractor’s initial CAS Disclosure Statement is adequate, conduct a detailed compliance review of the initial Statement to ascertain whether or not the disclosed practices comply with CAS and FAR Part 31 and advise the CFAO of the results;
- during the term of the contract, when requested, support the CFAO in, among other things, the CFAO’s
 - determining materiality
 - processing changes to cost accounting practices
 - processing noncompliances
 - resolving cost impacts.

The CFAO’s role

The CFAO for CAS administration must—

- after receiving the results of the auditor’s adequacy review of the contractor’s initial CAS Disclosure Statement to ascertain whether it is current, accurate, and complete, determine if the Statement is adequate;
- if the initial Statement is inadequate, notify the contractor of the inadequacies and request a revised initial Statement;
- notify the CO when necessary if the contractor has not provided an adequate initial Statement;
- if the initial Statement is adequate, notify the contractor (in writing), the auditor, and the CO;
- after receiving the results of the auditor’s detailed compliance review, either determine the initial Statement is compliant or take action regarding the potential noncompliance, notifying the CO when necessary;
- during the term of the contract, administer CAS per FAR Subpart 30.6 (notifying the CO when necessary)
 - determine materiality
 - process changes to cost accounting practices
 - process noncompliances
 - resolve cost impacts.

Final Indirect Cost Rates Determination

The contractor’s role

The contractor must—

- work with both the contract auditor and with the CFAO to make the proposal, audit, and negotiation process as efficient as possible;
- submit an “adequate” final indirect cost rate proposal annually within six months of the

end of its fiscal year (the Allowable Cost and Payment clause includes the criteria the contractor's proposal must meet to be adequate) both

- to the contract auditor, and
- to the CFAO;
- submit all supplemental information that may be required during the audit of its proposal;
- fulfill its responsibility for
 - accounting for costs appropriately
 - maintaining records, including supporting documentation adequate to demonstrate its claimed costs
 - have been incurred
 - are allocable
 - have been allocated appropriately, and
 - comply with
 - FAR subpart 31.2 in effect on the date of the contract
 - DEAR subpart 970.31 in effect on the date of the contract, and
 - the terms of the contract;
- understand that
 - no presumption of reasonableness attaches to its incurrence of a cost
 - the burden of proof is upon it to establish a cost is reasonable if the Government's initial review of the facts results in a challenge of the cost
 - regarding subcontracts, it is responsible for determining that its claimed cost-reimbursement subcontract costs are allowable (in its opinion) before submitting the costs for reimbursement and nothing in its determination or in any of its subcontract audit arrangements precludes the CFAO's final allowable cost determination;
- execute (after negotiations) a written understanding setting forth the final indirect cost rates.

The CO's role

The CO must—

- Insert DEAR clause 970.5216-7 Allowable Cost and Payment in the solicitation and contract;
- Within 30 days of contract award, request the CFAO fulfill the responsibilities of determining final indirect cost rates;
- When called for during the year, request the auditor perform limited scope audits of any contractor costs that merit special attention;
- Make the final determination of a cost's allowability if that authority has not been delegated to the CFAO, or it has been delegated but a dispute over the allowability of a cost is significant for any reason (due to the amount at issue, the policy at issue, etc.).

The contract auditor's role

The contract auditor must—

- if during the year the CO or CFAO requests the auditor perform a limited scope audit of any contractor costs that merit special attention, notify the CO or CFAO whether or not the request is accepted, and if it is, perform the audit and provide the CO or CFAO

the results;

- work both with the CFAO and with the contractor to make the proposal, audit, and negotiation process as efficient as possible;
- review the contractor's final indirect cost rate proposal for adequacy;
- provide a written description of any inadequacies in the contractor's proposal both to the contractor and to the CFAO;
- if unable to resolve the contractor's proposal inadequacies with the contractor, elevate the issue to the CFAO;
- once the contractor's proposal has been determined adequate, audit the proposal and send an advisory audit report to the CFAO;
- support the CFAO as a member of the Government negotiating team, whenever possible serving as an advisor at any negotiation or meeting with the contractor to determine final indirect cost rates; and
- when asked by the CFAO during the process of resolving the questioned costs in the contractor's proposal, provide an opinion on the allowability of the questioned costs.

The CFAO's role

The CFAO for determining final indirect cost rates must—

- when called for during the year, request the auditor perform limited scope audits of any contractor costs that merit special attention;
- work with the contract auditor and the contractor to make the proposal, audit, and negotiation process as efficient as possible;
- if the contract auditor is unable to resolve the contractor's proposal inadequacies with the contractor, work with the contractor, the contract auditor, or both to resolve them and notify the CO if necessary;
- after receiving the advisory audit report, provide a copy of it to the CO and review the report;
- head the Government negotiation team;
- develop a negotiation position and provide a copy to the CO;
- whenever possible, invite the contract auditor to serve as an advisor at any negotiation or meeting with the contractor on determining the contractor's final indirect cost rates;
- not resolve any questioned costs before obtaining adequate documentation and the contract auditor's opinion on the allowability of the costs;
- conduct negotiations, notifying the CO if a dispute over the allowability of a cost is significant for any reason (due to the amount at issue, the policy at issue, etc.);
- prepare a written final indirect cost rate agreement and provide a copy to the CO;
- prepare, sign, and place in the contractor general file a negotiation memorandum covering
 - the disposition of significant matters in the advisory audit report
 - reconciliation of all costs questioned
 - reasons for not following the contract auditor's or other Government officials' recommendations, and
 - certified cost or pricing data relied upon;
- distribute the indirect cost rate agreement and the negotiation memorandum per FAR Section 42.706;
- notify the contractor of the costs considered unallowable.

What is the guidance contained in this AL?

COs must understand, support, and fulfill their roles in the OIG's audit strategy, which uses the FAR to establish the contractor's and Government officials' roles in determining a M&O contractor's annual final indirect cost rates. In using this AL, COs must recognize that only some of the responsibilities of those roles are discussed (in some cases only briefly) in the background information section above. Finally, COs should note a point both fundamental and worthy of emphasis: FAR's Parts are interdependent. FAR Part 42, for example, discusses "indirect cost rate proposal" and the penalties for submitting "unallowable costs" implicitly using FAR Part 31's definition of "allowable costs" and FAR Parts 30's and 31's definitions of "direct cost," "indirect cost," and "cost objective." COs must recognize the interdependence of all of FAR's Parts in their (and other Government officials') efforts to ensure the Government only reimburses allowable costs.