



## DCMA Manual 2201-03 Final Indirect Cost Rates

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<b>Office of Primary Responsibility</b>	Negotiation Intelligence and Cost Evaluation Capability Board
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**Purpose:** This Manual, in accordance with the authority in DoD Directive 5105.64:

- Implements policy established in DCMA Instruction 2601, "Negotiation Intelligence and Cost Evaluation"
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## **SECTION 1: GENERAL ISSUANCE INFORMATION**

### **1.1. APPLICABILITY.**

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

### **1.2. POLICY.**

It is DCMA policy to monitor and ensure the contractor's effective management of contract costs by:

- a. Establishing final indirect cost rates (FICR).
- b. Disallowing unallowable costs.
- c. Assessing penalties and interest for expressly unallowable costs.
- d. Executing this Manual in a safe, efficient, effective, and ethical manner within all DCMA workspaces.

### **1.3. SUMMARY OF CHANGES.**

This Manual replaces DCMA Manual (DCMA-MAN) 2201-03, "Final Indirect Cost Rates," dated December 20, 2021. The following identifies the notable changes that have been incorporated in the Manual:

- Replaced DCMA Instruction 134, "Boards of Review," references with DCMA-MAN 2201-05, "Boards of Review"
- Replaced contracting officer with administrative contracting officer (ACO) for the general description used in the responsibilities
- Revised Paragraph 3.3.b. to describe contracting officer determined FICR versus auditor determined FICR
- Removed Paragraph 3.4. that referenced cycle times for closing contracts that are already covered in DCMA-MAN 2501-07, "Contract Closeout"
- Added the use of the Audit Tracking and Action Tool (AT-AT)/Contract Audit Follow-Up (CAFU) Checklist as highly recommended to ensure all questioned costs are resolved and dispositioned and penalties and interest are properly assessed and reviewed by DCMA supervision
- Revised Paragraphs 3.7.c. and 3.7.d. for cognizance of direct costs and delegation process
- Replaced references to the CAFU eTool with Agency's system of record

## **SECTION 2: RESPONSIBILITIES**

### **2.1. CONTRACT MANAGEMENT OFFICE (CMO) CONTRACTS DIRECTOR.**

The CMO Contracts Director:

- a. Serves as the reviewing official for assigned ACOs.
- b. Monitors the data integrity for databases used in FICR process.
- c. Verifies the penalties and interest calculations for assigned ACOs.

### **2.2. CORPORATE ADMINISTRATIVE CONTRACTING OFFICER (CACO)/DIVISIONAL ADMINISTRATIVE CONTRACTING OFFICER (DACO) DIVISION TEAM SUPERVISOR.**

The CACO/DACO Division Team Supervisor:

- a. Serves as the reviewing official for assigned CACOs and DACOs.
- b. Monitors the data integrity of databases used in FICR process.
- c. Verifies penalties and interest calculations for assigned CACOs and DACOs.

### **2.3. ACO.**

The use of ACO in this Manual includes the ACO, DACO, and CACO. This Manual will only use CACO, DACO, or CACO/DACO for responsibilities specific to the type of contracting officer. The ACO:

- a. Establishes the FICR for contractors.
  - (1) Established by the ACO for contractors outside the CACO/DACO Division.
  - (2) Established by the CACO or DACO for contractors within the CACO/DACO Division.
- b. Determines the allowability of costs and the assessment of penalties and interest for contractor proposed expressly unallowable costs.

## SECTION 3: PROCEDURES

### 3.1. INTRODUCTION.

a. Subpart 42.7 of the Federal Acquisition Regulation (FAR), “Indirect Cost Rates,” prescribes the policies and procedures for establishing billing rates and FICR. This Manual covers the establishment of FICR.

(1) FAR 42.703-1, “Policy,” Paragraphs (a) and (b) specify the policy for establishing FICR and using them for reimbursing indirect costs under cost-reimbursement contracts and in determining progress payments under fixed-price contracts.

(2) FAR 42.703-1(c) requires the use of FICR for contract closeout for a business unit and applies to all cost-reimbursement contracts at the business unit. It also requires the use of established FICR in negotiating the final price of fixed-price incentive and fixed-price redetermination contracts. If there is no established FICR, the ACO should consider using the quick-closeout procedures to closeout a specific contract.

(3) The ACO may use the quick-closeout procedure to settle costs for a specific contract for contract closeout prior to the establishment of the FICR. FAR 42.708, “Quick-Closeout Procedure,” and DCMA-MAN 2501-07 provide specific guidance for the use of the quick-closeout procedure.

(4) If the ACO needs field pricing assistance, refer to the Resource Page for the process of requesting assistance.

b. FAR 42.705, “Final Indirect Cost Rates,” and FAR 52.216-7, “Allowable Cost and Payment,” specifies the responsibilities of the ACO, auditor, and contractor in establishing FICR. The government may establish the FICR using one of the two procedures listed below.

- FAR 42.705-1, “Contracting officer determination procedure”
- FAR 42.705-2, “Auditor determination procedure”

c. This Manual also covers penalties for unallowable costs (FAR 42.709) and the disallowance of costs (Subpart 42.8 of the FAR) as it relates to establishing FICR.

d. Refer to Defense Federal Acquisition Regulation Supplement (DFARS) 242.705 for the applicability of DoD Class Deviation 2012-O0013, “DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals,” for establishing FICR. The Resource Page contains a copy of this class deviation.

e. See Defense Contract Audit Agency (DCAA) Memorandum 19-PAC-002(R), “Audit Alert on Identifying Expressly Unallowable Costs,” for revised DCAA policy on expressly unallowable costs. The Resource Page contains a copy of this DCAA memorandum.

### **3.2. CERTIFIED FICR PROPOSAL.**

#### **a. Submission of a FICR Proposal.**

FAR 52.216-7(d)(2) requires the contractor to submit an adequate FICR proposal to the cognizant contracting officer (DCMA ACO) and cognizant DCAA auditor within a 6-month period following the expiration of each of its fiscal years. The contractor must also submit adequate supporting data with the proposal. FAR 52.242-4 requires the contractor to certify the FICR proposal using the format in the clause.

#### **b. Time Extension for Submission of FICR Proposal.**

The ACO may grant an extension to the 6-month period in exceptional circumstances at the request of the contractor. The contractor must submit the request for an extension to the ACO in writing. The ACO should consult with the DCAA auditor prior to deciding on the time extension. After deciding to grant or deny the request, the ACO must follow the review and concurrence process in Paragraph 3.6.

##### **(1) ACO Denies Request and Reviewing Official Concurs.**

The ACO must document the circumstance and rationale for denying the extension in a memorandum for record (MFR). After receiving the reviewing official's concurrence, the ACO must send a written response to the contractor providing the rationale for denying the request. The ACO must place the MFR and a copy of the written response to the contractor in the FICR file.

##### **(2) ACO Grants Request and Reviewing Official Concurs.**

The ACO must document the circumstances and rationale for granting the extension in an MFR. After receiving the reviewing official's concurrence, the ACO must prepare a written response to the contractor and should notify the DCAA auditor prior to sending the written response to the contractor. The ACO must send a copy of the written response to the DCAA auditor and place a copy of the response and the MFR in the FICR file.

#### **c. Adequate FICR Proposal Not Submitted.**

When the ACO becomes aware (e.g., DCAA auditor notification) the contractor has not submitted an adequate certified FICR proposal (no proposal or an inadequate proposal submitted) as required by FAR 52.216-7, the ACO must contact the contractor. The ACO may initially contact, or attempt to contact, the contractor verbally (e.g., telephone call, face-to-face meeting) or electronically (e.g., e-mail). If the initial contact, or attempt to contact, does not result in the submission of a FICR proposal submission, the ACO must send the First Notification Letter to the contractor.

(1) First Notification Letter.

The ACO must prepare the letter using the First Notification Letter template located on the Resource Page within 30 days after becoming aware that the contractor did not submit an adequate FICR proposal. The letter must direct the contractor to respond using one of two options within 30 days after confirmed receipt.

(a) Option 1.

Submit a written request to the ACO for a time extension for the submission of an adequate certified FICR proposal. If the contractor submits a request for a time extension within the 30 days, the ACO must follow the process provided in Paragraph 3.2.b. to evaluate the request. If the contractor does not submit a time extension request, or the ACO denies the request, the ACO must send the contractor a Second Notification Letter.

(b) Option 2.

Submit an adequate certified FICR proposal to the ACO and DCAA auditor. If the contractor submits a FICR proposal, the ACO must follow the process in Paragraph 3.2.d. If the contractor does not submit a FICR proposal within the 30 days, the ACO must send the contractor a Second Notification Letter.

(2) Second Notification Letter.

If the First Notification Letter to the contractor does not result in an adequate FICR proposal, the ACO must prepare a Second Notification Letter using the Second Notification Letter template on the Resource Page. The ACO must send the Second Notification Letter within 30 days of the required response date from the First Notification Letter. This letter must:

(a) Direct the contractor to submit an adequate certified FICR proposal to the ACO and DCAA auditor within 30 days after confirmed receipt.

(b) Inform the contractor that the ACO may initiate the process of establishing the FICR unilaterally pursuant to FAR 42.703-2(c) if the contractor does not submit an adequate FICR proposal.

**d. FICR Proposal Adequacy Review.**

(1) Upon the receipt of the FICR proposal, FAR 42.705-1(b)(1)(iii) requires the DCAA auditor to review the adequacy of the proposal and resolve any inadequacies identified. If the auditor and contractor are unable to resolve the proposal's inadequacies identified by the auditor, the auditor will elevate the issue to the contracting office to resolve the inadequacies.

(a) If the DCAA auditor determines the FICR proposal inadequate, the ACO must follow the process prescribed in Paragraph 3.2.c.

(b) If the DCAA auditor determines the FICR proposal adequate, the ACO must next determine the procedures to use for establishing the FICR (see Paragraph 3.3.).

(2) The ACO may review the FICR proposal for adequacy. In addition to the review provided by the DCAA auditor, the ACO may request the assistance from other functional specialists in reviewing the FICR proposal and the supporting documents.

(3) The ACO must consider the results of the proposal adequacy review from the DCAA auditor and other functional specialists in determining if the contractor has submitted an adequate FICR proposal.

(4) The determination of an adequate FICR proposal does not mean all the costs claimed in the proposal are allowable, allocable, and reasonable. The ACO may disallow costs through cost adjustments where the ACO believes that the information provided by the contractor does not support costs claimed in the proposal. The disallowance of costs may also result in the assessment of penalties and interest.

**e. Contractor Lost or Destroyed Records or Out of Business.**

If the contractor cannot provide the records to support some of the costs claimed in the FICR proposal due to loss destruction of the records or no longer in business, the ACO must direct the contractor to obtain copies of the records from the third party associated with the costs claimed. The ACO must then determine if the records submitted adequately support the costs claimed in the FICR proposal. The ACO must then determine whether to allow or disallow the costs. If the ACO and the contractor cannot reach an agreement on the FICR, the ACO must establish the FICR unilaterally.

**f. Revised Billing Rates.**

The cognizant ACO may determine a historical decrement in consultation with the cognizant auditor and/or functional specialist in revising the billing rates. The ACO establishes billing rates for the reimbursement of incurred indirect costs subject to adjustment as necessary pending the establishment of the FICR. Refer to FAR 42.704, "Billing Rates," for guidance concerning the relationship between billing rates, a certified FICR proposal, and established FICR.

**3.3. FICR DETERMINATION PROCEDURES.**

**a. DCAA Audit.**

Upon the submission of an adequate FICR proposal and the completion of the proposal adequacy review, FAR 42.705-1(b)(2) requires the auditor to audit the FICR proposal and prepare an advisory report to the ACO. The FICR proposal may not receive an audit based on one of the following conditions:



(1) The ACO decides to accept the proposed FICR based solely on a DCAA's proposal adequacy review and the ACO is not aware of any factors or circumstances that place a given FICR proposal at risk for containing expressly unallowable costs as covered by FAR 42.709. The ACO must notify the cognizant DCAA office of this decision in writing (e.g., letter, e-mail).

(2) The auditor inquiries about providing a low-risk memorandum in accordance with (IAW) Defense Procurement and Acquisition Policy Class Deviation #2012-O0013. The Resource Page contains a copy of the DCAA Low-Risk Memorandum.

**b. DCAA Low-Risk Memorandum.**

Refer to DFARS 242.705 for the applicability of DoD Class Deviation #2012-O0013 for establishing FICR.

(1) Contracting Officer Determination Procedure.

The ACO must determine the FICR pursuant to FAR 42.705-1(a). If DCAA decides to issue a low-risk memorandum, the ACO may request the DCAA auditor to determine the FICR as prescribed at FAR 42.705-2(a)(2). The ACO and DCAA auditor must agree on the use of the auditor determination procedures to establish the FICR.

(a) If the ACO and DCAA auditor do not agree on using the auditor determination procedures, the ACO must establish the FICR using information from the low-risk memorandum and any other information provided by the DCAA auditor and available to the ACO. The ACO must also make the appropriate distribution of documents as prescribed in FAR 42.706.

(b) If the ACO and DCAA auditor do agree on using the auditor determination procedures, follow the procedures in Paragraph 3.3.b.(2).

(2) Auditor Determined FICR.

The Government (DCAA) auditor must determine the FICR pursuant to FAR 42.705-2(a)(1). If DCAA decides to issue a low-risk memorandum, the procedures below apply.

(a) The memorandum typically includes a fully executed FICR agreement signed by the contractor and the DCAA auditor. Upon receipt of the low-risk memorandum and the signed FICR agreement, the ACO must verify the DCAA auditor made the appropriate distribution of documents as prescribed in FAR 42.706. If DCAA did not make the appropriate distribution of documents, the ACO must perform the distribution. If the low-risk memorandum does not include a FICR agreement, the ACO must contact the DCAA auditor concerning the FICR determination.

(b) The ACO must also follow the records and database management requirements in Paragraph 3.9.

(3) Corporate Allocations.

When DCAA issues a low-risk memorandum at the business segment level of a large contractor prior to the final impact of corporate allocation or intermediate home office (IHO) settlements, the ACO should provide written notification of the low-risk memorandum to the CACO, any applicable DACO, and any applicable ACO covering an IHO. The ACO should obtain CACO or DACO concurrence prior to settling the indirect costs at the business segment. If the CACO or DACO completes the settlement of corporate or IHO costs prior to the ACO's resolution and disposition of the low-risk memorandum, the ACO must include the resulting final impact of the corporate or IHO cost allocations to the applicable business segment being settled by the ACO.

(4) Documents and Distribution.

If the low-risk memorandum did not include the FICR agreement letter, the ACO must contact DCAA to request the missing documents. If the ACO cannot retrieve the requested FICR agreement document from DCAA in a reasonable amount of time (as determined by the ACO), the ACO must accept the proposed rates as the FICR for the applicable fiscal year for the contractor. The ACO must execute a FICR agreement with the contractor (using the template on the Resource Page) and explain the decision to accept the proposed rates in an MFR. Accepting the proposed FICR under a low-risk memorandum does not require the ACO to prepare a Pre-Negotiation Objectives Memorandum (PNOM) or Price Negotiation Memorandum (PNM). The ACO must perform the appropriate distribution of documents pursuant to FAR 42.706. The ACO must also document the date and method of transmittal of any documents sent to DCAA. The ACO must also follow the records and database management requirements in Paragraph 3.9.

**c. Select FICR Determination Procedure.**

The ACO must decide which FICR determination procedure to use for establishing the FICR (see FAR 42.705(a)).

(1) Contracting Officer Determination Procedure.

FAR 42.705-1(a) identifies the applicability and responsibility of the contracting officer determination procedure.

(a) For business units of a multidivisional corporation covered by the CACO/DACO Division, the cognizant CACO/DACO must establish the FICR.

(b) For business units without a cognizant CACO but with a resident ACO, the resident ACO must establish the FICR. If a nonresident ACO devotes at least 75 percent of their time to a single contractor, the nonresident ACO must establish the FICR.

(c) For business units not included in Paragraphs (a) or (b) above, the cognizant ACO must determine whether to use the contracting officer determination or the auditor determination procedure for establishing the FICR.

(d) FAR 42.705-1(a)(4)-(6) requires the use of the contracting officer determination procedure for establishing the FICR for an educational institution, state and local government, and nonprofit organization contracts.

(e) DFARS 242.705-1 provides supplemental guidance for the contracting officer determination procedure.

(f) If the ACO selects the contracting officer determination procedure, the ACO must follow the procedures in FAR 42.705-1, FAR 52.216-7, and the supplemental guidance in this Manual.

(g) The ACO may consider accepting the proposed FICR without negotiation if the DCAA audit had no questioned costs. The ACO may also accept the proposed FICR without negotiation without a DCAA audit if the ACO considers the proposed FICR as a low risk to the Government. The ACO must prepare an MFR for the FICR file detailing the rationale for accepting the proposed FICR without negotiating.

## (2) Auditor Determination Procedure.

FAR 42.705-2 specifies when this procedure applies, the responsibilities of the DCAA auditor, and the procedures the auditor must follow to establish the FICR. If the DCAA auditor and the contractor cannot reach a FICR agreement:

(a) FAR 42.705-2(b)(2)(iv) requires the DCAA auditor to forward the audit to the ACO to resolve the disagreement.

(b) DFARS 242.705-2(b)(2)(iii) requires the auditor to issue a DCAA Form 1, “Notice of Contract Costs Suspended and/or Disapproved,” when an auditor and the contractor cannot reach a FICR agreement in addition to an advisory report to the ACO. Refer to Paragraph 3.7. for additional guidance on a DCAA Form 1.

(c) The ACO must now use the contracting officer determination procedure for establishing the FICR.

## **3.4. FICR NEGOTIATION.**

### **a. Negotiation Team.**

The ACO should assemble a negotiation team consisting of the DCAA auditor, any functional specialists assisting in the review of the proposal and its supporting documents, and representation from other DCMA components or external departments or agencies affected by the establishment of the FICR.

**b. Pre-Negotiation Objectives (PNO).**

The ACO must develop the Government's negotiation position prior to negotiating the FICR with the contractor. The ACO must consider all the input provided during the review of the FICR proposal (e.g., DCAA audit, functional specialists reports) in developing the PNO. The ACO must include the documents provided during the review in the FICR file.

(1) Audit Report.

The ACO must consider all questioned, unsupported, and unresolved costs identified by the DCAA audit report. The ACO should contact the DCAA auditor with any questions concerning the recommendations and findings in the DCAA audit report. Pursuant to FAR 42.705-1(b)(4), the ACO must obtain DCAA's follow-up opinion on the allowability of the costs after their review of the additional documentation provided by the contractor. The ACO may receive a written or verbal opinion from the DCAA auditor. The ACO should request the DCAA auditor to follow up their verbal opinion with a confirming e-mail. If the DCAA auditor does not send a confirming e-mail, the ACO must include the verbal opinion in the PNOM. The ACO must include the DCAA auditor's opinion in the FICR file.

(2) Audit Opinions.

DCAA Manual 7640.1, "DCAA Contract Audit Manual," 2-102 provides the descriptions of the different types of attestation engagements and level of assurance that each provide in relation to the auditor's opinion or conclusions. The auditor can provide an unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion. The ACO should contact the auditor with any questions concerning the type of opinion stated in the audit report.

(a) When an ACO receives an audit report that is qualified, the ACO must consider the nature and impact of the costs that are affected by the qualified opinion. A common reason for a qualified opinion is the results of an assist audit are still pending when the report was issued. In some instances, the qualified audit opinion may relate to subcontract costs that are a type of direct cost. Subcontract costs typically have no impact relative to settling a prime contractor's FICR. The ACO may request an assist audit on the subcontract costs if the ACO believes the subcontractor costs may affect the prime contractor's FICR.

(b) Some qualified audit opinions may relate to pending audits associated with intracompany cost allocations included from a home office, from an IHO, or from a shared services group. The ACO may need to settle or establish FICR without waiting for the results of pending audits of intracompany cost allocations.

1. The ACO may decide not to wait for the results of a pending audit if the ACO determines the applicable intracompany cost allocations will have no material impact on the rates.

2. The ACO may decide not to wait for the results of a pending audit if the ACO determines the additional time could result in exceeding regulatory time limits, such as those prescribed at FAR 4.804-1(a)(2-4) and FAR 33.206.

(c) When an ACO receives an audit report that includes an adverse opinion or disclaimer of opinion, the ACO must address the non-compliant issues included in the audit report. Although the audit report may not include any penalty assessments, the ACO must determine if the non-compliant issues relate to expressly unallowable costs.

(d) The ACO must make an affirmative statement agreeing or disagreeing with each finding and recommendation made by DCAA. The statement must demonstrate that the ACO has considered all appropriate FAR, DFARS, DoD policy, and DCMA issuances related to the issue raised or questioned by DCAA (e.g., cost principles or cost accounting standards).

(e) After an ACO identifies all qualifications contained in the audit report, the ACO must document all steps taken to mitigate the auditors' scope limitation in the appropriate memorandum (e.g., PNOM, PNM, MFR). The "Scope Limitation" section of a DCAA audit report contains the auditor's qualifications. The ACO's mitigation efforts must explain how the ACO plans to negotiate the costs impacted by the audit report's scope limitation (e.g., when an auditor did not perform certain auditing procedures). The ACO must contact the auditor to learn if the auditor performed any new audit efforts or other analysis since issuing the incurred cost audit report. The ACO must document the auditor's efforts to mitigate the qualifications found in the prior qualified audit report. The ACO must include any additional information obtained from the contractor, auditors, functional specialists, and/or procuring contracting officer (PCO) in the FICR file.

(3) Functional Specialist Input.

The ACO must make an affirmative statement agreeing or disagreeing with each finding and recommendation made by the DCMA functional specialists (e.g., price/cost analyst, engineer, general counsel). The statement must demonstrate that the ACO has considered all appropriate FAR, DFARS, DoD policy, and DCMA issuances related to the issue raised.

(4) Penalties.

See Paragraph 3.8. for determining the applicability of penalties for expressly unallowable costs.

(5) PNOM.

The ACO must document the PNO in a PNOM using the template located on the Resource Page and obtain the appropriate level of review and concurrence IAW Paragraph 3.6.

**c. Negotiating the FICR.**

The ACO negotiates with the contractor to reach a bilateral agreement on the FICR.

(1) Do not enter negotiations with a contractor under investigation by a government agency. If during negotiations the ACO discovers the contractor is under investigation, the ACO must contact their general counsel for advice on how to proceed.

(2) The ACO must invite contracting offices having significant dollar interest to participate in the negotiation pursuant to FAR 42.705-1(b)(3). If DCAA issued an audit, the ACO should consider inviting the auditor to serve as an advisor at negotiations pursuant to FAR 42.705-1(b)(4). One of the goals of these negotiations should include seeking collective agreement towards the settlement of all auditor questioned costs. Prior to negotiations, CACOs and DACOs are encouraged to invite affected ACOs to post-audit exit conferences held by DCAA.

(a) The ACO must negotiate and finalize all business segment issues under their cognizance while waiting for applicable corporate or other flow-down costs.

1. When settling business segment cost matters, the ACO must follow the guidance on PNOM and PNM documentation. Likewise, the ACO must obtain a written agreement with the contractor that documents settlement of specific business segment cost items. See the Resource Page for a PNOM and PNM templates.

2. Upon receipt of applicable corporate or other flow-down costs, the ACO must finalize the FICR agreement.

(b) The ACO must execute final rate agreements for a business segment/division when unsettled flow-down costs (e.g., corporate, other business segments, service centers) do not apply to that business segment/division.

(3) If the ACO and contractor cannot reach an agreement on the FICR, FAR 52.216-7(d)(4) identifies this as a dispute within the meaning of FAR 52.233-1, “Disputes.” Refer to Paragraph 3.5. concerning the unilateral establishment of the FICR and DCMA-MAN 2501-09, “Contract Claims and Disputes,” for additional guidance regarding disputes.

(4) IAW DoD Instruction 7640.02, resolve reportable audits within six months of report issuance and disposition audits within 12 months of report issuance unless another regulation or policy provides for a shorter timeline. If the resolution or disposition of the audit report is not completed within the timeline stated, the ACO will document actions taken at least monthly in the Agency’s system of record for the portion(s) of the audit that the ACO has authority and responsibility.

#### **d. Document Negotiation Results.**

Except when using a DCAA low-risk memorandum, the ACO must document the results of the negotiation in a PNM using the template located on the Resource Page.

(1) The PNM must include the following content:

(a) An affirmative statement either agreeing or disagreeing with each finding and recommendation provided by the DCAA auditor or DCMA functional specialists. This includes recommendations concerning the assessment of any penalties and interest.

(b) Sound rationale for resolving each finding and recommendation made by the DCAA auditor or DCMA functional specialists and whether or not the assessment of any penalties and interest is appropriate.

1. The rationale must demonstrate that the ACO has considered all appropriate FAR, DFARS, and DCMA issuances related to the issue raised or questioned by DCAA (e.g., cost principles or cost accounting standards).

2. The ACO must separately identify all intracompany flow-down costs used to reach a business segment FICR agreement. This demonstrates the ACO properly identified and considered the impact of other negotiated intracompany flow-down costs by comparing the proposed versus the settlement by the CACO or cognizant DACOs. The ACO must document the rationale for not using, or waiting for, final settled intracompany flow-down costs.

(c) A reconciliation of all costs questioned with identification of items and amounts allowed or disallowed in the FICR agreement.

(d) The disposition of period costs or with allocability issues.

(e) An explanation of any deviations taken from a prior position contained in the PNOM relative to reaching the FICR agreement.

(f) An identification of cost or pricing data submitted during the negotiations and relied upon in reaching a FICR agreement including the assessment of any penalties and interest.

(2) The ACO may establish the FICR without resolving the questioned direct costs in the DCAA audit if there is no impact on the rates. The ACO must discuss this issue with the cognizant CACO or DACO prior to executing the FICR agreement.

(3) If the ACO resolves any questioned direct costs in the DCAA audit, the ACO must execute a bilateral agreement with the contractor on the resolution of the direct costs. The ACO may incorporate the agreement on the direct costs into the FICR agreement or in a separate bilateral agreement with the contractor. The agreement must document direct costs at the individual contract level. See Paragraph 3.7.c.(1)(a) for determining the contracting officer responsible for questioned direct costs.

**e. Execute FICR Agreement.**

After the ACO and contractor negotiate all the indirect costs on the FICR audit, the ACO must execute the FICR agreement as required by FAR 52.216-7(d)(3) using the template on the Resource Page. Prior to executing the FICR agreement, the ACO must obtain the appropriate level of review and concurrence for the PNM (or MFR) as prescribed in Paragraph 3.6. The ACO should include the proposed/draft FICR agreement with the PNM (or MFR) in the review and concurrence process.

(1) After receiving concurrence on the PNM or MFR and preparing the draft FICR agreement, the ACO should send the FICR agreement to the contractor for signature. The ACO will execute the agreement when returned from the contractor by signing and distributing copies of the FICR agreement and PNM (or MFR) pursuant to FAR 42.706 and the subparagraphs below.

(a) The ACO must provide the contractor with a copy of the executed FICR agreement.

(b) The ACO must provide executed copies of the FICR agreement and the PNM to each affected contracting office and the DCAA auditor(s).

(c) Although implied by FAR 42.706, ACOs regularly contacting the CACO/DACO Division should be sent the FICR agreement and PNMs (or MFRs) as the ACO updates the Contract Business Analysis Repository. When an ACO settles questioned direct costs, the ACO must provide a copy of the finalized PNM to the DACO. The CACO/DACO should use the PNM (or MFR) to disposition the findings as required by DCMA-MAN 2201-04, "Contract Audit Follow-Up."

(d) As a courtesy, the ACO should provide a copy of the PNM (or MFR) to any organization that provided written recommendations.

(2) As part of the agreement, the contractor must update the billings on all contracts to reflect the FICR and update the schedule of cumulative direct and indirect costs claimed and billed within 60 days after the FICR agreement as directed by FAR 52.216-7(d)(2)(v). This expanded requirement of FAR 52.216-7(d)(2)(v) only applies when contained in contracts awarded on or after May 31, 2011.

(3) If the contractor does not submit timely contract completion invoices or vouchers, the ACO must follow the guidance at FAR 42.705(c). The ACO must communicate and secure the settlement or final voucher IAW FAR 52.216-7(d)(5).

#### **f. Negotiation Documents.**

The ACO must include the documents used in the negotiation of the FICR in the FICR file. The ACO must document the date and method of transmittal of the PNM (or MFR) and FICR agreement to DCAA. Refer to Paragraph 3.9. for records and database management.

### **3.5. ESTABLISH FICR UNILATERALLY.**

a. If the contractor fails to submit an adequate FICR proposal within the required timeframe or the ACO cannot negotiate a FICR with the contractor, the ACO must initiate the process of unilaterally establishing the FICR. The Resource Page provides additional guidance for both interactions with the contractors and the establishment of unilateral indirect cost.

b. The ACO must try to resolve the issues preventing an agreement on the FICR prior to establishing them unilaterally. If the ACO decides to establish the FICR unilaterally, this



decision constitutes a contracting officer's final decision (COFD) and may result in a claim against the contractor (see FAR 33.211). The COFD must include the appeal rights of the contractor. The ACO must use the appropriate COFD template located on the Resource Page.

c. Prior to executing the COFD, the ACO must obtain the appropriate level of review and concurrence for the COFD IAW Paragraph 3.6.

d. The contractor may request to re-negotiate the FICR after receiving the ACO's COFD. The ACO must consult with assigned general counsel before engaging in the re-negotiation and settlement discussions with the contractor prior to a contractor appeal. If the ACO proceeds, the ACO may use the previously approved PNOM or the COFD as the PNOM for the re-negotiation. If the ACO plans to change the Government's objectives, the ACO must prepare a new PNOM. If the ACO and contractor reach a FICR agreement, the ACO must prepare a PNM to document the results of the re-negotiation.

### **3.6. REVIEW AND CONCURRENCE.**

#### **a. Reviewing Official Concurrence.**

The CMO contracts director or CACO/DACO Division team supervisor must review and concur with the proposed action identified below prior to any further action by the ACO.

##### **(1) FICR Proposal Submission Time Extension.**

The reviewing official concurs with the ACO's decision to grant or deny a time extension by signing the MFR.

##### **(2) PNO.**

The reviewing official concurs with the PNO by signing the PNOM.

##### **(3) FICR Agreement and PNM.**

The reviewing official concurs with the negotiated FICR agreement and the results of the negotiation by signing the PNM.

##### **(4) Unilaterally Established FICR.**

The reviewing official concurs by initialing on the coordination package for the COFD.

#### **b. ACO and Reviewing Official Disagree.**

If the reviewing official does not concur with the ACO's decision, the ACO should discuss the non-concurrence with the reviewing official. The ACO and reviewing official should attempt to reach an agreement.

(1) The reviewing official may decide to concur with the ACO's decision, or the ACO may change their decision resulting in a concurrence from the reviewing official.

(2) If the ACO and the reviewing official cannot agree on the extension request, the ACO may make the decision without a concurrence from the reviewing official. The ACO must prepare and sign an MFR for the official file with the rationale for proceeding without concurrence.

### **c. Legal Review.**

When an ACO needs an interpretation of law, regulation, or authority, the ACO must consult with general counsel. The ACO must seek recommendations from their Component's general counsel on an analysis of law and regulation if the ACO's rationale for disagreeing with an audit finding is based on some type of legal interpretation. After consulting with general counsel, the ACO must document (in both the PNOM and subsequent PNM) the ACO's rationale for disagreeing with the reported audit findings or recommendations. In both the PNOM and PNM, the ACO must document how they consulted with general counsel and management relative to these types of audit findings that were not sustained. All COFDs and any decision to set unilateral rates require legal counsel review.

### **d. Boards of Review (BoRs).**

The ACO must refer to DCMA-MAN 2201-05, for any BoR requirement.

### **e. Procedural Tolling Agreements.**

A procedural tolling agreement is a potential tool for protecting both the Government and a contractor from exceeding the 6-year Contract Disputes Act (CDA) statute of limitations time window (Chapter 71 of Title 41, United States Code). The parties must enter into a tolling agreement prior to the expiration of the 6-year CDA statute of limitations in order to suspend the imposition of the statutory time bar for a specified time-period. This agreement means the specified period-of-time in the tolling agreement does not count when determining whether the Government's claim is time-barred under the CDA statute of limitations. In some circumstances, an ACO's use of a procedural tolling agreement will be in the Government's best interest. Before considering the potential use of a tolling agreement, the ACO must consult with local general counsel.

## **3.7. DCAA FORM 1 AND DISALLOWANCE OF COSTS.**

### **a. Disallowance of Costs Applicability.**

FAR 42.802 requires the inclusion of FAR Clause 52.242-1, "Notice of Intent to Disallow Costs," for cost-reimbursement, fixed-price incentive, or price redetermination contracts. This clause gives the contracting officer the authority to issue a written notice of intent to disallow specific costs determined unallowable by the contracting officer. This authority applies to costs the contractor has already incurred and costs the contractor has planned to incur.

**b. Disallowance of Costs Identification.**

The ACO may learn of potential unallowable costs from several sources such as:

(1) Cost monitoring activities may disclose potential cost allowability problems. For more information on cost monitoring activities, see DCMA-MAN 2201-01, “Forward Pricing Rates.”

(2) DCMA Price/Cost Analysts may identify unallowable costs during proposal evaluations or other ACO support.

(3) DCAA audit of a price proposal or forward pricing rate proposal may disclose a cost allowability issue before a cost is incurred. In such cases, DCAA may also issue a DCAA Form 1.

(4) 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.

**c. Disallowance of Costs Responsibilities.**

When the ACO becomes aware of potential unallowable costs, the ACO must identify the contracting officer responsible for these costs. If delegated the authority, an ACO has the responsibility to resolve issues in controversy (see FAR 42.302(a)(10)), and to determine the allowability of costs suspended or disapproved pursuant to FAR 42.302 (a)(7). If not delegated the authority, the ACO must defer the issue to a PCO.

(1) The ACO must consider the type of costs under dispute in order to identify any other contracting officer who is responsible for determining the allowability of the questioned costs.

(a) If the disputed costs are direct costs, the responsible contracting officer is determined by the date of the audit.

1. If the DCAA audit was issued on or prior to March 22, 2023, then DCMA ACOs have the responsibility to resolve and disposition the costs by working through the cognizant PCO for supporting documentation and concurrence. For assistance in locating a PCO, the ACO may use the “PCO locator tool” or the Defense Logistics Agency DoD activity address search tool located on this Manual’s Resource Page.

2. If the DCAA audit was issued after March 22, 2023, then the PCO has the responsibility to resolve and disposition the costs pursuant to DFARS 242.302(b)(S-71)(A) and (B). The PCO may delegate this authority, except for classified contracts, to the ACO only upon prior coordination with the ACO and agreement by the contracts director. If the PCO contacts the ACO about delegation, the ACO should provide a cost-benefit analysis to the first line supervisor with the final determination made by the contracts director. The contracts director must ensure the denial of a direct cost delegation and reason is documented in an MFR and

should maintain a list of denied direct cost delegations. The contracts director should ensure the accepted delegations are properly documented in Mechanization of Contract Administration Services (MOCAS). The ACO should document MOCAS with code “DC” (Direct Cost Delegation) under the “R9 Remarks” for when the delegation has been accepted. The PCO initiated and signed final delegation letter or direct cost delegation denial MFR must be stored in the FICR file.

(b) If the questioned costs involve elements of indirect cost, the ACO must identify the appropriate ACO responsible for settling final indirect rates impacted by the questioned indirect costs. The ACO responsible for settling final indirect rates must 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).

(c) If the questioned costs involve elements of indirect cost allocated to other business segments, the ACO must coordinate with other impacted ACOs and/or auditors. These ACOs, auditors, and contractor representatives may need to be engaged in discussions to reach a satisfactory settlement.

(2) When evaluating costs for possible disallowance, the ACO must first review the affected contracts to determine if the contracts contain FAR 52.242-1. If a contract does not contain, or is not required to contain, FAR 52.242-1, the ACO must consult general counsel as to whether to address the cost issue on this contract or other contracts.

(3) The ACO must use the criteria found in FAR 31.201-2 in determining the allowability of a cost.

(4) The ACO must consider whether potential unallowable costs have any directly associated costs (see FAR 31.201-6, Accounting for Unallowable Costs) that the ACO’s determination must cover. The cognizant auditors should be able to advise the ACO on the adequacy of the contractor's accounting system to identify unallowable costs and their directly associated costs. The contractor must exclude these costs from any billing, claim, or proposal applicable to a Government contract containing FAR 52.216-7. FAR 31.201-6 provides guidelines on the contractor’s responsibilities in properly accounting for unallowable costs.

(5) If the ACO does not sustain a DCAA audit finding, the DCAA auditor may challenge the ACO’s decision by requesting a DCMA BoR. The ACO must refer to DCMA-MAN 2201-05 and take the appropriate action.

(6) As required in FAR 42.801(a), the ACO responsible for administering a contract must make every reasonable effort to reach a satisfactory settlement of the unallowable cost finding through discussions with the contractor. The goal of the discussions is to avoid the need to issue a notice of intent to disallow costs.

**d. Questioned Direct Cost Responsibilities.**

If DCAA reports questioned direct costs incurred, with or without the issuance of a DCAA Form 1, the cognizant contracting officer must resolve the questioned costs relative to the impacted contract.

(1) The PCO is responsible for settling questioned direct costs unless the PCO delegated responsibility to the ACO and was accepted per DFARS 242.302(b)(S-71)(A). The assigned duties are at the “each contract assigned” level. Thus, if a contract administration decision must be made (relative to the allowability of direct costs and resolving issues in controversy), then the PCO or ACO delegated these duties must do so relative to the affected contract. It does not matter if direct costs questioned by DCAA are also in an allocation base identified in a FICR proposal for an ACO to settle. The PCO or ACO with delegated duties must settle the questioned direct costs associated with the affected contract.

(2) DFARS 242.302(b)(S-71) was issued on March 22, 2023. Prior to this date, DCMA contracting officers were resolving and dispositioning all questioned direct costs. The ACO should continue to follow this process for audit reports issued prior to March 22, 2023. See Paragraph 3.7.c.(1)(a) above.

(3) The receipt of a DCAA Form 1 is a separate contract action from the ACO settling final indirect rates. The receipt of a DCAA Form 1 should not preclude an agreement on the FICR or disposition of the audit in the Agency’s system of record.

(4) For contractors within the CACO/DACO Division, the ACO must notify the CACO or DACO the contract and dollar amount when the delegated direct cost has been accepted. The CACO or DACO should document the ACO’s accepted delegation within the Agency’s system of record.

(5) Refer to DCMA-MAN 2201-04 Resource Page for DCMA’s highly recommended AT-AT/CAFU Checklist for the disposition requirements for an audit with assessed penalties.

(6) The ACO may establish the FICR with or without settling the questioned direct costs.

(7) When the DCAA incurred cost audit includes questioned direct costs addressed to a DoD contracting officer, the ACO must hold the Agency’s system record for the audit open until all questioned direct costs are settled. The ACO must add pertinent notes in the comments section of the open record in the Agency’s system of record explaining why the record remains open along with the status of resolving the questioned direct costs. The ACO should indicate in the notes if the PCO is responsible for any of the questioned direct costs.

(8) When an ACO settles questioned direct costs, the ACO must provide a copy of the approved PNM or MFR to the DACO, if there is a DACO assigned, and provide the PCO results of the settlement per DFARS 242.302(b)(S-71)(B). After the contract ACO settles the questioned direct costs, the DACO can complete disposition of the audit in the Agency’s system of record. The ACO must ensure the sustained direct cost adjustments are made at the contract

level. The ACO should remove code “DC” from MOCAS after the ACO has negotiated a settlement.

**e. Notice of Intent to Disallow Costs.**

(1) Notice of Intent to Disallow – Decision.

If the ACO and the contractor do not agree on the allowability of the costs, the ACO may consider issuance of a notice of intent to disallow the costs pursuant to FAR 42.801. The ACO has authority to issue a written notice of intent to disallow costs under cost-reimbursable contracts, fixed-price incentive contracts, and contracts allowing for price redetermination if the contract contains FAR 52.242-1.

(a) Before issuing a notice that involves elements of indirect costs, the ACO must first seek advice from the cognizant DCAA office that provides audit support for an agreement on the FICR. Consultation with the appropriate auditors is required pursuant to FAR 42.801(e). After obtaining input from DCAA, the cognizant ACO for settling final indirect rates must 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)).

(b) Before issuing the notice of intent to disallow (direct and indirect) costs, the ACO must obtain management review of the notice from the CMO contracts director or CACO/DACO Division team supervisor and comply with any BoR requirement.

(c) If the ACO decides to issue a notice of intent to disallow costs, follow procedures as pursuant to FAR 42.801(c), which lists the minimum elements needed in the written notice.

(2) Notice of Intent to Disallow – Contractor Response.

If the contractor submits a timely written response disagreeing with the notice, the ACO must withdraw the notice or issue a COFD as required by FAR 42.801(f) within 60 days after receipt of the contractor response. For the contractor's written response to be timely, it must be submitted within the timelines identified in the notice of intent to disallow costs.

(3) Notice of Intent to Disallow – Withdrawal of Notice or Issues COFD.

If the ACO withdraws the notice or issues a COFD to the contractor, the ACO must take the following steps:

(a) If the ACO relies on the DCAA audit report, the ACO must prepare an MFR for the FICR file with 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 issuances related to the issues raised or questioned by DCAA. Additionally, the ACO must document, in the MFR, the date of the auditor’s discovery of the unallowable cost. The purpose of documenting this date of auditor discovery is to identify when

the auditors first discovered the unallowable cost as a potential accrual of claim date. See FAR 33.206 and DCMA-MAN 2501-09. The ACO must contact general counsel to identify the most appropriate accrual of claim date for the possibility of making this determination later. Refer to Paragraph 3.6.c. for legal review requirements.

(b) For both a withdrawal notice and a COFD, the ACO must obtain review of all documentation by the CMO contracts director or CACO/DACO Division team supervisor. For a COFD, the ACO must request a review by general counsel and the Contracts Dispute Resolution Center.

(c) The ACO must issue the withdrawal notice or a COFD within 60 days of receipt of the contractor's written response as required by FAR 42.801(b).

(4) Distribution.

After issuing a written notice or decision to the contractor, the ACO must furnish copies of any notice of intent to disallow costs, withdrawal notice, or the COFD to all ACOs cognizant of any business segment of the contractor's organization, even if not affected by the indirect cost allocations pursuant to FAR 42.801(d).

**f. Settle DCAA Form 1.**

(1) DCAA Terms and Definitions Related to a DCAA Form 1.

(a) Chapter 6, Section 6-902, of DCAA Manual 7640.1 provides DCAA with the general guidance for the suspension and disapproval of direct or indirect costs and 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." The ACO need not take any action relative to a DCAA Form 1 that "suspends" costs unless the contractor submits a request for reconsideration.

(b) The DCAA CAM describes "disapproved" costs as, "Costs claimed by the contractor for which audit action has been completed, and which are not considered allowable." "Disapproved costs" can come from different circumstances described below:

1. Cost restrictions identified in Part 31 of the FAR or identified in the terms of a contract.

2. Costs that are not explicitly unallowable under Part 31 of the FAR but are considered by the auditor "to be unreasonable in amount, contrary to generally accepted accounting principles, or not properly allocable to the contract IAW the relative benefit received or other equitable relationship."

3. Costs previously disapproved by the ACO.

(2) Notification and Response to Disallowed Costs.

While monitoring performance on contracts, the ACO may become aware of incurred costs that have been disallowed or should be disallowed.

(a) The ACO may be notified of these disallowed costs by an auditor via a DCAA Form 1 or a memorandum that is separate from an audit report or it may be attached to an audit report.

(b) DCAA may issue these DCAA Form 1s when the auditor is unable to reach agreement with the contractor on auditor determined rates.

(c) The ACO may also be notified of disallowed costs from other ACOs, Cost Monitors, or other functional specialists.

(d) The ACO with appropriate delegated authority is responsible to make the determination on cost allowability.

(e) When the ACO becomes aware of disallowed costs, the ACO must follow all applicable procedures found within this Manual to resolve the issue and settle the final rates. The ACO must consider the disallowed costs when developing a PNOM to settle final rates. The ACO must consider whether the identified unallowable costs have directly associated costs, as defined in FAR 31.201-6(a), even if DCAA did not identify such. If DCAA does not identify such costs in a DCAA Form 1, the ACO must inquire about directly associated costs requiring further identification by DCAA.

(f) An ACO may need to issue a COFD when a contractor files a claim or dispute in response to disallowed costs.

(g) 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 procedures below. However, since host nation auditors do not use the DCAA Form 1, the ACO must create a DCAA Form 1. The ACO should also use the DCAA Form 1 as a ready means to notify the contractor of disallowed costs. ACO use of a DCAA Form 1 is covered in DFARS 242.803(b)(ii)(B).

(3) Contractor Requests ACO Decision.

If the contractor submits a written request asking the CO to determine whether to pay the unreimbursed costs (disallowed by a DCAA Form 1) or files a claim under the Disputes clause, the ACO must take one or more of these actions:

(a) Follow the steps described in Paragraph 3.7.c. to identify all appropriate ACOs responsible to settle the matters in controversy identified in the DCAA Form 1 or other form of notification.

(b) Fully consider all DCAA findings and recommendations.



(c) Prepare a written decision and withdraw the notice within 60 days if the ACO finds that the costs should be paid (see FAR 33.211(c)).

(d) Negotiate a settlement within 60 days and prepare an applicable PNOM, PNM and/or MFR.

(e) Issue a COFD within the statutory time limitations found at FAR 33.211(c).

(f) If the ACO will not be able to render a decision within 60 days, then the ACO must:

1. Immediately establish target dates for required actions to support the COFD (e.g., additional inputs from DCAA, required general counsel reviews) and the target date for making the decision and provide the schedule to the CMO contracts director or the CACO/DACO Division team supervisor, as applicable.

2. Obtain management review of the target schedule (to ensure the schedule meets the statutory timelines) from the applicable CMO contracts director or the CACO/DACO Division team supervisor.

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

(g) Prior to reaching a settlement with the contractor, releasing a withdrawal notice, or issuing a COFD to the contractor, the ACO must:

1. Prepare an MFR or PNOM for the FICR file with an affirmative statement on whether the ACO agreed or disagreed with each audit finding and recommendation. The affirmative statements must provide sound rationale for resolving each audit finding and recommendation. The rationale must demonstrate how the ACO has considered all appropriate FAR, DFARS, and DCMA issuances related to the issues raised or questioned by DCAA. Additionally, the ACO must document, in the MFR, the date of discovery of the unallowable cost.

2. Obtain management review from the CMO contracts director or CACO/DACO Division team supervisor and comply with any BoR requirement before issuing a withdrawal notice, negotiating a settlement, or making a COFD.

3. The ACO and the CMO contracts director or the CACO/DACO Division team supervisor must obtain the appropriate guidance from the assigned general counsel, the Contract Disputes Resolution Center, and other advisors for a COFD. Refer to Paragraph 3.6.c. for legal review requirements.

(4) Recovery of Costs.

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 must take steps to recoup the disapproved costs (direct and associated indirect). For more information on the recovery of contract costs, see DCMA-MAN 2501-10, "Contract Debts." The ACO must not take any action to allow the contractor to receive payment for some or all costs suspended or disallowed by DCAA prior to withdrawing the notice, negotiating a settlement, or issuing a COFD.

(5) Determining Allowability.

The ACO must use the criteria found in FAR 31.201-2 in determining the allowability of a cost.

(6) Allocations Associated with Unallowable Costs.

Questioned direct costs generally do not affect final overhead rate calculations, because the costs are usually part of an allocation base and not in an expense pool. Costs questioned that are part of the allocation base must remain part of the allocation base since they should receive their allocable share of indirect costs.

### **3.8. DETERMINING PENALTIES AND INTEREST.**

#### **a. Penalties for Unallowable Costs.**

FAR 42.709 covers penalties against contractors who include unallowable indirect costs in their FICR proposal. The ACO must evaluate penalties recommended by DCAA and inform DCAA of the disposition of the recommendations. If the ACO, DCAA auditor, or other government official suspect the contractor may have knowingly submitted unallowable costs, the ACO must refer to the appropriate Contract Integrity Center counsel.

#### **b. Types of Penalties.**

FAR 52.242-3 and FAR 42.709-2 identify the types of penalties the ACO may or must assess or waive for unallowable costs included in the FICR proposal.

(1) Level One Penalty (FAR 42.709-2(a)(1)).

This type of penalty applies to the indirect costs claimed identified as expressly unallowable under a cost principle in FAR 31.205 or an executive agency supplement to the FAR. The penalty equals the amount of the disallowed costs allocated to contracts subject to penalty.

(2) Level Two Penalty (FAR 42.709-2(a)(2)).

This type of penalty applies if the ACO determines the contractor knew the FICR proposal included an unallowable indirect cost prior to submission. The penalty equals two times the amount of disallowed costs allocated to contracts subject to penalty. Evidence of prior determinations of unallowable cost include:

(a) A DCAA Form 1, or any similar notice, the contractor elected not to appeal and not withdrawn by the cognizant Government agency.

(b) A COFD the contractor elected not to appeal.

(c) A prior executive agency Board of Contract Appeals or court decision involving the contractor, which upheld the cost disallowance; or determination or agreement of unallowable cost under FAR 31.201-6.

**c. Penalties and Interest.**

The ACO must assess the appropriate penalties and calculate the interest amount pursuant to FAR 42.709-4 and FAR 42.709-5 unless waived pursuant to FAR 42.709-6. The ACO cannot negotiate the amount of penalties and interest to assess. Refer to the Resource Page for guidance on the calculation of penalties and interest.

(1) Computing Interest.

For unallowable indirect costs subject to penalty and already paid to the contractor through the interim billing process, the ACO must compute the applicable interest portion of the penalty using the procedures in FAR 42.709-5.

(2) Assessing the Penalty.

To assess a penalty, the ACO must issue a COFD (see FAR 33.211) and include a demand for payment of any assessed penalty. The letter must state that the determination is a COFD under FAR 52.233-1. Demanding payment of the penalty is separate from demanding repayment of any paid portion of the disallowed cost. A COFD may need to cover either matter or both matters (as appropriate under the circumstances). See DCMA-MAN 2501-09 for any applicable procedures related to issuing a COFD.

(a) If the contractor receives payment for unallowable costs billed to the Government, the ACO must issue a COFD demanding repayment for any paid portion of a disallowed cost unless the exception in FAR 32.604(c) is applicable.

(b) If the ACO assessed a penalty on an unallowable cost claimed in a FICR proposal, the ACO must issue a COFD demanding the payment of the assessed penalty and interest due as computed pursuant to FAR 42.709-4 and FAR 42.709-5.

(c) If the contractor uses decremented billing rates, the contractor may claim they never billed the Government for the unallowable costs because the contractor intentionally decremented their billing rates to prevent the billing of unallowable costs. The contractor may use a decrement to cover for unallowable costs later accidentally not excluded (as required by FAR 31.201-6). However, the assessment of a penalty may still apply if the contractor includes the unallowable costs in the FICR proposal regardless of the interim billings. Consult with the assigned general counsel on the impact of the contractor's decremented billing rates.

(d) The ACO must document in the FICR file copies of the COFD letter and any other appropriate documents. After providing DCAA a copy of the COFD letter, the ACO must document the date and method of transmittal.

#### **d. Waiver of the Penalty.**

##### (1) Required Waiver Conditions.

FAR 42.709-6 specifies when the cognizant contracting officer (ACO) must waive the penalty (and the calculated interest). Review FAR 42.709-6 and additional guidance concerning penalties on the Resource Page prior to waiving the penalties.

##### (2) Legal Review.

FAR 42.709 does not require the ACO to obtain a legal review prior to granting a waiver of the penalty pursuant to FAR 42.709-6. The ACO may request legal review. However, if the total amount of penalties the ACO determines to waive exceeds \$10,000, this Manual requires the ACO to request a legal review from their Component's general counsel.

##### (3) Document Waiver of the Penalty.

The ACO must document the waiver of the penalty in the PNOM if the ACO decided to waive the penalty prior to establishing the PNO. The ACO must document the waiver of the penalty in the PNM. If the ACO decides not to negotiate and therefore does not prepare a PNOM or PNM, the ACO must use an MFR to document the waiver of the penalty. The MFR must include the ACO's decision and action taken concerning a waiver of the penalty under FAR 42.709-6. The ACO must also send a Penalty Waiver determination letter to the contractor identifying the expressly unallowable costs and explaining why the ACO waived the assessment of a penalty. See the Resource Page for the PNOM, PNM, MFR, and Penalty Waiver letter templates.

### **3.9. RECORDS AND DATABASE MANAGEMENT.**

#### **a. Records Management.**

The DCMA Records and Information Management policy and procedures as identified in DCMA-MAN 4501-04, Volume 1, "Records and Information Management Program," and Volume 2, "Records Retention Schedule," provide an orderly system for organizing records for

filing and eventual disposition that must be followed. The ACO must retain copies of all final versions of DCAA Form 1s, audit reports, MFRs, written communications, legal advice, management review documents, written notices, COFD documents, and documents referenced for the FICR file as stated or implied elsewhere in this Manual. The ACO must retain all versions of the contractor's FICR proposal. The ACO must name the files and use the appropriate metadata to allow for clear identification and retrieval IAW DCMA-MAN 4501-04, Volume 1. Additional information on the proper storage of FICR records is identified in the Records File Plan, located on the Resource Page. The ACO must account for all the DCAA Form 1s in the Agency's system of record.

**b. Database Tracking.**

(1) Database Tracking.

The ACO must input, update, and/or correct all applicable databases from the receipt of FICR proposals, to eventual FICR agreement, through any applicable penalty assessment/collection. The use of the databases is mandatory for both contracting officer negotiated and audit-determined final indirect rates. For any delay in the FICR process the ACO must make proper notations in the applicable Agency's system of record explaining the reason for the delay.

(a) Agency's System of Record.

The ACO will follow procedures for resolving and dispositioning reportable audits as prescribed in DCMA-MAN 2201-04. Upon acceptance of the record in the Agency's system of record, the ACO may begin utilization of the highly recommended AT-AT/CAFU Checklist located on the 2201-04 Resource Page. The appropriate CMO contracts director or CACO/DACO Division team supervisor must verify the ACO is following procedures contained in DCMA-MAN 2201-04 when reviewing the PNOM to give management concurrence. For host nation (non-DCAA) audits, refer to the Agency's system of record.

1. Tracks the overhead negotiation activity of the FICR process.

2. Tracks Form 1s issued by DCAA or DCMA ACOs.

(b) Contract Business Analysis Repository.

Update the final indirect rates section of the Contract Business Analysis Repository for all applicable Commercial and Government Entity Codes IAW TAB A of DCMA Memorandum 15-031, "Populating and Maintaining Data in Contract Business Analysis Repository."

(c) Records File Plan.

The ACO must store records IAW the Records File Plan, located on the Resource Page.

(2) Data Integrity Monitoring.

The contracts director or the CACO/DACO Division team supervisor must establish local internal controls monitoring data integrity for any database impacted by the process of establishing final indirect costs rates and settling final incurred costs whether direct or indirect.

## GLOSSARY

### G.1. ABBREVIATIONS AND ACRONYMS.

ACO	administrative contracting officer
AT-AT	Audit Tracking and Action Tool
BoR	board of review
CACO	corporate administrative contracting officer
CAFU	contract audit follow-up
CDA	Contract Dispute Act
CMO	contract management office
COFD	contracting officer's final decision
DACO	divisional administrative contracting officer
DCAA	Defense Contract Audit Agency
DCAA Form 1	Notice of Contract Costs Suspended and/or Disapproved
DCMA-MAN	DCMA Manual
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulation
FICR	final indirect cost rates
IAW	in accordance with
IHO	intermediate home office
MFR	memorandum for record
MOCAS	Mechanization of Contract Administration Services
PCO	procuring contracting officer
PNO	Pre-Negotiation Objectives
PNOM	Pre-Negotiation Objectives Memorandum
PNM	Price Negotiation Memorandum

## GLOSSARY

### G.2. DEFINITIONS.

<b>Claim</b>	As defined in FAR 52.233-1, “means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to this contract.”
<b>COFD</b>	A COFD has the same meaning as the “contracting officer’s decision” or the “final decision of the contracting officer” as used in FAR 33.211.
<b>Directly Associated Cost</b>	As defined at FAR 31.001, means any cost which is generated solely as a result of the incurrence of another cost, and which would not have been incurred had the other cost not been incurred.
<b>FICR File</b>	A repository for the documents the ACO relied upon to establish the FICR.
<b>DCAA Form 1</b>	A DCAA Form 1 is a standardized form created by DCAA and used to notify contractors that certain types of costs are suspended or disapproved for payment when claimed on billing vouchers submitted under Government flexibly priced contracts. IAW DFARS 242.803(b)(i)(D), a DCAA Form 1 is issued “to deduct costs where allowability is questionable.” Host nation auditors will not supply a DCAA Form 1 but may supply an advisory memorandum.
<b>Fiscal Year End</b>	A consecutive 12-month period selected by a business entity for financial reporting to interested parties such as stockholders, banking institutions, and/or governments. This 12-month period may or may not match the 12-calendar-month period. The fiscal year ending date is the last day of the last month of the selected 12-month period.
<b>Host Nation</b>	The nation that performs the Government Quality Assurance or financial audit services in their nation on behalf of another nation within the North Atlantic Treaty Organization. Typically, a Host Contract Administration Services Audit Authority performs the financial audit services. When DCMA performs the Government Quality Assurance or financial audits in this capacity, the United States is the host nation.



## REFERENCES

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- DCMA Instruction 2601, "Negotiation Intelligence and Cost Evaluation," May 17, 2024
- DCMA Manual 2201-01, "Forward Pricing Rates," April 24, 2024
- DCMA Manual 2201-04, "Contract Audit Follow-Up," November 25, 2022
- DCMA Manual 2201-05, "Boards of Review," December 20, 2021
- DCMA Manual 2401-01, "Negotiation Intelligence Procedures," December 20, 2018, as amended
- DCMA Manual 2501-07, "Contract Closeout," January 14, 2019, as amended
- DCMA Manual 2501-09, "Contracts Disputes and Claims," March 26, 2018
- DCMA Manual 2501-10, "Contract Debts," January 3, 2022
- DCMA Manual 4501-04, Volume 1: "Records and Information Management Program," April 16, 2021
- DCMA Manual 4501-04, Volume 2: "Records Retention Schedule," April 14, 2021
- DCMA Memorandum 15-031, "Populating and Maintaining Data in Contract Business Analysis Repository," February 12, 2015
- Defense Procurement and Acquisition Policy Memorandum #2012-O0013, "Class Deviation – DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals," July 24, 2012
- Defense Federal Acquisition Regulation Supplement (DFARS), current edition
- DoD Directive 5105.64, "Defense Contract Management Agency (DCMA)," January 10, 2013, as amended
- DoD Instruction 7640.02. "Policy for Follow-Up on Contract Audit Reports," April 15, 2015
- Federal Acquisition Regulation (FAR), current edition
- United States Code, Title 41, Chapter 71