



DCMA Manual 2201-03

Final Indirect Cost Rates

Office of Primary Responsibility	Indirect Cost Control Capability
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Purpose: This issuance under the authority of DoD Directive 5105.64, "Defense Contract Management Agency (DCMA)":

- Implements the policy established in DCMA Instruction 2201
- Assigns responsibilities and defines the procedures for establishing final indirect cost rates.

SUMMARY OF CHANGES

This Manual was rewritten. The following identifies the most notable changes:

- Combined some of the 2-number paragraphs (e.g., 3.1, 3.2., 3.3) based on the content
- Changed the sequence of the SECTION 3 paragraphs
- Removed paragraph 3.4 “USE OF QCR WHERE POSSIBLE” because it is covered in DCMA Manual 2501-07, “Contract Closeout”

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SECTION 1: GENERAL ISSUANCE INFORMATION

1.1. APPLICABILITY.

This Manual applies to all DCMA Components unless higher-level issuances, agreements, or guidance takes 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, and
- d. Executing this Manual in a safe, efficient, effective, and ethical manner.

1.3. DELEGATION.

The individual assigned specific duties and responsibilities within this Manual may delegate them to the appropriate level unless expressly prohibited by the Manual or high-level guidance.

SECTION 2: RESPONSIBILITIES

2.1. CONTRACT MANAGEMENT OFFICE CONTRACTS DIRECTOR.

The Contract Management Office (CMO) Contracts Director:

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

2.2. CORPORATE AND DIVISIONAL ADMINISTRATIVE CONTRACTING OFFICER DIVISION TEAM SUPERVISOR.

The Corporate and Divisional ACO (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. CONTRACTING OFFICER.

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

- a. Establishes the FICR for contractors.
 - (1) Established by the ACO for contractors outside the CACO/DACO network.
 - (2) Established by the CACO or DACO for contractors within the CACO/DACO network.
- 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. Federal Acquisition Regulation (FAR) Subpart 42.7, “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 redeterminable contracts. If no established FICR, the CO should consider using the quick-closeout procedures to closeout a specific contract.

(3) The CO 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 Manual (DCMA-MAN) 2501-07, “Contract Closeout,” provide specific guidance for the use of the quick-closeout procedure.

(4) If the CO 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 CO, 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 (FAR Subpart 42.8) 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,” dated July 24, 2012, 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,” dated May 14, 2019, for revised DCAA policy on expressly unallowable costs. The Resource Page contains a copy of this DCAA memo.

3.2. CERTIFIED FINAL INDIRECT COST RATES PROPOSAL.

a. Submission of a FICR Proposal. FAR 52.216-7, paragraph (d)(2), requires the contractor to submit an adequate FICR proposal to the cognizant CO (DCMA ACO, CACO, or DACO) 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 CO 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 CO in writing. The CO should consult with the DCAA auditor prior to making a decision on the time extension. After making a decision on granting or denying the request, the CO must follow the review and concurrence process in Paragraph 3.6.

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

(2) CO Grants Request and Reviewing Official Concurs. The CO must document the circumstances and rationale for granting the extension in an MFR. After receiving the reviewing official's concurrence, the CO must prepare a written response to the contractor and notify the DCAA auditor prior to sending the written response to the contractor. The CO 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 CO 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 CO must contact the contractor. The CO 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 CO must send the First Notification Letter to the contractor.

(1) First Notification Letter. The CO must prepare the letter using the 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 to one of two options within 30 days after confirmed receipt.

(a) Option 1. Submit a written request to the CO 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 CO 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 CO denies the request, the CO must send the contractor a second notification letter.

(b) Option 2. Submit an adequate certified FICR proposal to the CO and DCAA auditor. If the contractor submits a FICR proposal, the CO must follow the process in Paragraph 3.2.d. If the contractor does not submit a FICR proposal within the 30 days, the CO 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 CO must prepare a second notification letter using the Second Notification Letter template on the Resource Page. The CO must send the Second Notification Letter within 30 days 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 CO and DCAA auditor within 30 days after confirmed receipt, and

(b) Inform the contractor that the CO 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 review the adequacy of the proposal and resolve any inadequacies identified. The CO should coordinate with the DCAA auditor concerning a FICR proposal adequacy review.

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

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

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

(3) The CO 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 CO's determination of an adequate FICR proposal does not mean all the costs claimed in the proposal are allowable, allocable, and reasonable. The CO may disallow costs through cost adjustments where the CO 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 CO must direct the contractor to obtain copies of the records from the third party associated with the costs claimed. The CO must then determine if the records submitted adequately support the costs claimed in the FICR proposal. The CO must then determine whether to allow or disallow the costs. If the CO and the contractor cannot reach an agreement on the FICR, the CO must establish the FICR unilaterally.

f. Revised Billing Rates. The cognizant CO may determine a historical decrement in consultation with the cognizant auditor and/or functional specialist in revising the billing rates. The CO 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. FINAL INDIRECT COST RATES 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 CO. The FICR proposal may not receive an audit based on one of the following conditions.

(1) The CO decides to accept the proposed FICR based solely on a DCAA's proposal adequacy review and the CO 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 CO must notify the cognizant DCAA office of this decision in writing (e.g., letter, e-mail).

(2) The auditor inquires about providing a low-risk memorandum in accordance with (IAW) Defense Procurement and Acquisition Policy (DPAP) Class Deviation #212-O0013, (DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals, July 24, 2012). 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, "DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals," issued on July 24, 2012, for establishing FICR.

(1) The memo 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 CO 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 CO must perform the distribution. If the low-risk memorandum does not include a FICR agreement, CO must contact the DCAA auditor concerning the FICR determination. The CO must also follow the records and database management requirements in Paragraph 3.9.

(2) 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 CO should provide written notification of the low-risk memo 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 IHO DACO complete 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.

(3) If the low-risk memo did not include the FICR agreement letter or the cumulative allowable cost worksheet, 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 memo does not require the ACO to prepare a PNOM or PNM. The ACO must perform the appropriate distribution of documents as prescribed in 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 CO must decide which FICR determination procedure to use for establishing the FICR (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 network, 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 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 CO selects the contracting officer determination procedure, the CO must follow the procedures in FAR 42.705-1, FAR 52.216-7, and the supplemental guidance in this Manual.

(g) The CO may consider accepting the proposed FICR without negotiation if the DCAA audit had no questioned costs. The CO may also accept the proposed FICR without negotiation without a DCAA audit if the CO considers the proposed FICR as a low risk to the Government. The CO 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 CO to resolve the disagreement.

(b) DFARS PGI 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 CO. Refer to Paragraph 3.7., for additional guidance on a DCAA Form 1.

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

3.4. FINAL INDIRECT COST RATES NEGOTIATION.

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

b. Prenegotiation Objectives (PNO). The CO must develop the Government’s negotiation position prior to negotiating the FICR with the contractor. The CO 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 CO must include the documents provided during the review in the FICR file.

(1) Audit Report. The CO must consider all questioned, unsupported, and unresolved costs identified by the DCAA audit report. The CO 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 CO 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 CO may receive a written or verbal opinion from the DCAA auditor. The CO 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 CO must prepare an MFR to document the verbal opinion. The CO must include the DCAA auditor’s opinion in the FICR file.

(2) Qualified Audit Report or Disclaimer of Opinions. When a CO receives an audit

report that is qualified (e.g., results of an assist audit still pending), the CO must consider the nature and impact of the costs that are affected by the qualified opinion. In some instances, an audit report may report a “disclaimer of opinion.” DCAA Manual (DCAAM) 7640.1, “DCAA Contract Audit Manual,” (DCAA CAM) explains when DCAA auditors should disclaim an audit opinion. The DCAA CAM instructs how an “audit team should disclaim an opinion when they are unable to obtain sufficient appropriate audit evidence (i.e., not all planned audit procedures could be completed) and its potential effects are material and pervasive.” The DCAA CAM further elaborates on the term “pervasive” in the context of audit “engagement” (i.e., total audit effort). The DCAA CAM explains, “In this context, pervasive means that the possible impact of the audit procedures not performed can affect a substantial portion of the subject matter under audit and is generally not confined to specific cost elements.”

(a) In some instances, the qualified audit opinion (due to another pending assist audit report) 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 CO may request an assist audit (covering subcontract costs) if the CO 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 CO may need to settle or establish FICR without waiting for the results of pending audits of intracompany cost allocations.

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

2. The CO may decide not to wait for the results of a pending audit if the CO determines the additional time could result in exceeding regulatory time limits, such as those prescribed at FAR 4.804-1(a)(3) and FAR 33.206.

(c) When a CO receives an audit report that includes a disclaimed audit opinion, the CO must address the non-compliant issues included in the “Other Matters to be Reported” section of the audit report. When the auditor disclaims an opinion, the auditor is prohibited from including a “Results of Audit” section or using the term “questioned cost.” Although the audit report may not include any penalty assessments, the CO must determine if the non-compliant issues relate to expressly unallowable costs.

(d) The CO must make an affirmative statement agreeing or disagreeing with each finding and recommendation made by DCAA. The statement must demonstrate that the CO 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 a CO identifies all qualifications contained in the audit report, the CO 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 CO’s mitigation efforts must explain how

the CO 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 CO 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 CO must document the auditor's efforts to mitigate the qualifications found in the prior qualified audit report. The CO 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 CO 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 CO has considered all appropriate FAR, DFARS, DoD policy, and DCMA issuances related to the issue raised.

(4) See Paragraph 3.8., for determining the applicability of penalties for expressly unallowable costs.

(5) The CO 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 CO negotiates with the contractor in an effort to reach a bilateral agreement on the FICR. The cycle time for negotiating the FICR for major contractors is 27 months and 36 months for non-major contractors. DCAA defines a major contractor as a contractor with over \$100 million in auditable dollar volume.

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

(2) The CO must invite contracting offices having significant dollar interest to participate in the negotiation per the requirements of FAR 42.705-1(b)(3). If DCAA issued an audit, the CO 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 other affected ACOs to post-audit exit conferences held by DCAA.

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

1. When settling business segment cost matters, the CO must follow the guidance on PNOM and PNM documentation. Likewise, the CO 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 CO

must finalize the FICR agreement.

(b) COs 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 CO 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.

d. Document Negotiation Results. Except when using a DCAA low-risk memorandum, the CO 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 CO 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. Additionally, the CO 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 what the proposed versus the settlement by the CACO or cognizant DACOs. Further, the CO 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 CO may establish the FICR without resolving the questioned direct costs in the DCAA audit as long as the issue is with allowability and not allocability. A CO must discuss this issue with the cognizant CACO or DACO prior to executing the FICR agreement.

(3) If the CO resolves any questioned direct costs in the DCAA audit, the CO must execute a bilateral agreement with the contractor on the resolution of the direct costs. The CO 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.

e. Execute FICR Agreement. After the CO and contractor negotiate an agreement on the FICR, the CO 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 CO must obtain the appropriate level of review and concurrence for the PNM (or MFR) as prescribed in Paragraph 3.6. The CO must include the proposed FICR agreement signed by the contractor with the PNM (or MFR) in the review and concurrence process.

(1) After receiving concurrence of the PNM or MFR and contractor signed FICR agreement, the CO must sign and distribute copies of the FICR agreement and PNM (or MFR) pursuant to FAR 42.706 and the subparagraphs below.

(a) The CO must provide the contractor with a copy of the executed FICR letter.

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

(c) Although implied by FAR 42.706, ACOs within a CACO/DACO network must mutually distribute rate determination letters and PNMs (or MFRs) to each other as applicable. 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). However, 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 found in 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 CO must include the documents used in the negotiation of the FICR in the FICR file. The CO 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 FINAL INDIRECT COST RATES UNILATERALLY.

a. If the contractor fails to submit an adequate FICR proposal within the required timeframe or the CO cannot negotiate a FICR with the contractor, the CO 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 CO must try to resolve the issues preventing an agreement on the FICR prior to establishing them unilaterally. If the CO 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 (FAR 33.211). The COFD must include the appeal rights of the contractor. The CO must use the appropriate COFD template located on the Resource Page.

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

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 CO.

(1) FICR Proposal Submission Time Extension. The reviewing official concurs with the CO'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. CO and Reviewing Official Disagree. If the reviewing official does not concur with the CO's decision, the CO should discuss the non-concurrence with the reviewing official. The CO

and reviewing official should attempt to reach an agreement on granting or denying the request.

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

(2) If the CO and the reviewing official agree on the extension request, the CO may make the decision without a concurrence from the reviewing official. The CO must prepare and sign an MFR for the official file with the rationale for proceeding without concurrence.

c. Legal Review. When a CO needs an interpretation of law, regulation, or authority, the CO must consult with general counsel. The CO must seek recommendations from their Component's general counsel on suitable wording if the CO's rationale for disagreeing with an audit finding is based on some type of legal interpretation. After consulting with general counsel, the CO must document (in the both the PNOM and subsequent PNM) the CO's rationale for disagreeing with the reported audit findings or recommendations. In both the PNOM and PNM, the CO must document how he/she consulted with general counsel and management relative to these types of unsustainable audit findings. All COFDs and any decision to set unilateral rates requires legal counsel review.

d. Boards of Review (BoR). The CO must refer to DCMA Instruction (DCMA-INST) 134, "Boards of Review," 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. 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, a CO's use of a procedural tolling agreement will be in the Government's best interests. Before considering the potential use of a tolling agreement, the CO 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 CO the authority to issue a written notice of intent to disallow specific costs determined unallowable by the CO. This authority applies to costs the contractor has already incurred and costs the contractor has planned to incur.

b. Disallowance of Costs Identification. The CO 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 CO 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, a CO may deal with host nation auditors rather than DCAA auditors. If host nation auditors identify a potential cost allowability problem to the CO, the CO will follow the same steps covered in this policy.

c. Disallowance of Costs Responsibilities. When the CO becomes aware of potential unallowable costs, the CO must identify the contracting officer responsible for these costs. If delegated the authority, a CO has the responsibility to resolve issues of 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 CO must defer the issue to a PCO.

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

(a) If the disputed costs are direct costs, the CO must identify the cognizant PCO or delegated CO if applicable. For assistance in locating a PCO, the CO may use the “PCO locator tool” located on DCMA360. The Resource Page has a link to the tool.

(b) If the questionable costs involve elements of indirect cost, the CO must identify the appropriate CO responsible for settling final indirect rates impacted by the questioned indirect costs. The CO responsible for settling final indirect rates must issue the notice to disallow indirect costs. Similarly, the CO 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 questionable costs involve elements of indirect cost allocated to other business segments, the CO must coordinate with other impacted contracting officers and/or auditors. These COs, auditors, and contractor representatives may need to be engaged in discussions to reach a satisfactory settlement.

(2) When evaluating costs for possible disallowance, the CO 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 CO must consult general counsel as to whether to address the cost issue on this contract or other contracts.

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

(4) The CO must consider whether potential unallowable costs have any directly

associated costs (see FAR 31.201-6) that the CO's determination must cover. The cognizant auditors should be able to advise the CO 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 CO does not sustain a DCAA audit finding, the DCAA auditor may challenge the CO's decision by requesting a DCMA Board of Review. The CO must refer to DCMA-INST 134 and take the appropriate action.

(6) As required in FAR 42.801(a), the CO 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 contract CO must still resolve the questioned costs relative to the impacted contract.

(1) If a CO is delegated responsibilities covered by FAR 42.302(a)(7), (a)(8), and (a)(10), 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 CO 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 the DACO to settle. The CO with the delegated duties "for each contract assigned for administration" must settle the questioned direct costs associated with the affected contract.

(2) In instances where a CO receives a DCAA incurred cost audit report that identifies questioned direct costs, the CO must immediately notify (to include providing a copy of the DCAA audit report) the contract CO or PCO of the questioned direct costs and appropriate required actions.

(3) The receipt of a DCAA Form 1 is a separate contract action from the CO 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 Contract Audit Follow-Up (CAFU) system. Refer to DCMA-MAN 2201-04 for the disposition requirements for an audit with assessed penalties. When the DCAA incurred cost audit includes questioned direct costs addressed to a CO, the CO must disposition the audit in the appropriate database (i.e., CAFU system). The CO may establish the FICR with or without settling the questioned direct costs. If the CO establishes the FICR without resolving all questioned direct costs, the CO must hold the CAFU system record open until the questioned direct costs are settled. The CO must add pertinent notes in the comments section of the open record in the CAFU system explaining why the record remains open along with the status of resolving the questioned direct costs. When a contract ACO settles questioned direct costs, the ACO must provide a copy of the approved PNM to the DACO. After

the contract ACO settles the questioned direct costs, the DACO can complete disposition of the audit in the appropriate database as described in DCMA-MAN 2201-04.

e. Notice of Intent to Disallow Costs.

(1) Notice of Intent to Disallow – Decision. If the CO and the contractor do not agree on the allowability of the costs, the CO may consider issuance of a notice of intent to disallow the costs pursuant to FAR 42.801. The CO 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 CO 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 CO responsible 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 costs, the ACO must obtain management review of the notice from the CMO Contracts Director and any BoR requirement. Before issuing the notice of intent to disallow costs, CACOs and DACOs must obtain management review of the notice from the CACO/DACO Division Team Supervisor.

(c) If the CO decides to issue a notice of intent to disallow costs, follow procedures as set forth in FAR 42.801(c) pertaining to a list of 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 CO 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 as explained in FAR 42.801(c)(5).

(3) Notice of Intent to Disallow – Withdrawal of a COFD. If the CO withdraws the notice or issues a COFD to the contractor, the CO must take the following steps:

(a) If the CO relies on the DCAA audit report, the CO must prepare an MFR for the FICR file with an affirmative statement that the CO 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 CO has considered all appropriate FAR, DFARS, and official DCMA issuances related to the issues raised or questioned by DCAA. Additionally, the CO 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 see DCMA-MAN 2501-09. The CO 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. CACOs and DACOs must obtain review from the CACO/DACO Division Team Supervisor. For a COFD, the ACO/CACO/DACO must request a review by general counsel and the Contracts Dispute Resolution Center (CDRC).

(c) The CO 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 CO must furnish copies of any notice of intent to disallow costs, withdrawal notice, or the COFD to all contracting officers cognizant of any business segment of the contractor's organization, even if not affected by the indirect cost allocations per the requirements of FAR 42.801(d).

f. Settle DCAA Form 1

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

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

(b) DCAA 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 FAR Part 31 or identified in the terms of a contract.

2. Costs that are not explicitly unallowable under FAR Part 31 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 CO.

(2) Notification and Response to Disallowed Costs. During the course of monitoring performance on contracts, the CO may become aware of incurred costs that have been disallowed or should be disallowed.

(a) The CO 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 they are unable to reach agreement with the contractor on auditor determined rates.

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

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

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

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

(g) In circumstances where a CO is dealing with host nation auditors rather than DCAA auditors, the host nation auditors may identify cost allowability issues to a CO. In such cases, the CO will generally follow the same procedures below. However, since host nation auditors do not use the DCAA Form 1, the CO must create a DCAA Form 1. The CO should also use the DCAA Form 1 as a ready means to notify the contractor of disallowed costs. CO use of a DCAA Form 1 is covered in DFARS 242.803(b)(ii)(B).

(3) Contractor Requests CO 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 CO must take one or more of these actions:

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

(b) Fully consider all DCAA findings and recommendations.

(c) Prepare a written determination and withdraw the notice within 60 days if the CO 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 CO will not be able to render a decision within 60 days, then the CO 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, or releasing a withdrawal notice or issuing a COFD to the contractor, the CO must:

1. Prepare an MFR or PNOM for the FICR file with an affirmative statement on whether the CO 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 CO has considered all appropriate FAR, DFARS, and official DCMA issuances related to the issues raised or questioned by DCAA. Additionally, the CO must document, in the MFR, the date of discovery of the unallowable cost.

2. Obtain management review from the CMO Contracts Director and any BoR requirement (DCMA-INST 134), before issuing a withdrawal notice, negotiating a settlement, or making a COFD. CACOs and DACOs must obtain management review by the CACO/DACO Division Team Supervisor, and any BoR requirement (DCMA-INST 134) before issuing a withdrawal notice, negotiating a settlement, or making a COFD.

3. The CO and the CMO Contracts Director or the CACO/DACO Division Team Supervisor must obtain the appropriate guidance from the assigned general counsel, the CDRC, 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 CO need not take further action unless the contractor has overbilled on a contract with no future billings under the contract. In such instances, the CO 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 CO 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 CO 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 CO must evaluate penalties recommended by DCAA and inform DCAA of the disposition of the recommendations. If the CO, DCAA auditor, or other Government official suspect the contractor may have knowingly submitted unallowable costs, the CO must refer to the appropriate Contract Integrity Center counsel.

b. Types of Penalties. FAR 52.242-3 and FAR 42.709-1 identify the types of penalties the CO may or must assess or waive for unallowable costs included in the FICR proposal.

(1) Level One Penalty. 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. This type of penalty applies if the CO determines the contractor knew the FICR proposal included an expressly 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 unallowability:

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

(b) A COFD the contractor elected not to appeal, or

(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 unallowability under FAR 31.201-6.

c. Penalties and Interest. The CO must assess the appropriate penalties and calculate the interest amount pursuant to FAR 42.709-3 and FAR 42.709-4 unless waived IAW FAR 42.709-5. The CO 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 expressly unallowable indirect costs subject to penalty and already paid to the contractor through the interim billing process, the CO

must compute the applicable interest portion of the penalty using the procedures at FAR 42.709-4.

(2) Assessing the Penalty. To assess a penalty, the CO must issue a COFD pursuant to the requirements of 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 guidance related to issuing a COFD.

(a) If the contractor receives payment for unallowable costs billed to the Government, the CO 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 CO assessed a penalty on an unallowable cost claimed in a FICR proposal, the CO must issue a COFD demanding the payment of the assessed penalty and interest due as computed per the requirements of FAR 42.709-3 and FAR 42.709-4.

(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.

(d) The CO 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 CO must document the date and method of transmittal.

d. Waiver of the Penalty.

(1) Required Waiver Conditions. FAR 42.709-5 specifies when the cognizant contracting officer (ACO/CACO/DACO) must waive the penalty (and the calculated interest) at FAR 42.709-1(a). Review FAR 42.709-5 and additional guidance concerning penalties on the Resource Page prior to waiving the penalties.

(2) Legal Review. FAR 42.709 does not require the CO to obtain a legal review prior to granting a waiver of the penalty pursuant to FAR 42.709-5. However, if the total amount of penalties the CO determines to waive exceeds \$10,000, this Manual requires the CO to request a legal review from their Component's general counsel.

(3) Document Waiver of the Penalty. The CO must document the waiver of the penalty in the PNOM if the CO decided to waive the penalty prior to establishing the PNO. The CO must document the waiver of the penalty in the PNM. If the CO decides not to negotiate and therefore does not prepare a PNOM or PNM, the CO must use an MFR to

document the waiver of the penalty. The MFR must include the CO's decision and action taken concerning a waiver of the penalty under FAR 42.709-5. The CO must also send a Penalty Waiver Letter to the contractor identifying the expressly unallowable costs and explaining why the CO 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 CO must retain copies of all final versions of DCAA Form 1s, audit reports, MFRs, written communications, legal advice, management review documents, written notices, and COFD documents as stated or implied elsewhere in this Manual. The CO must retain all versions of the contractor's FICR proposal. DCMA-MAN 4501-04, Volume 1: "Records and Information Program," prescribes the Agency's records retention requirements. The CO must account for all the DCAA Forms 1 in the appropriate database.

b. Database Tracking.

(1) Database Tracking. COs 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 database is mandatory for both CO negotiated and audit-determined final indirect rates. For any delay in the FICR process the CO must make proper notations in the applicable eTool/database explaining the reason for the delay.

(a) CAFU eTool. The CO will follow procedures for resolving and dispositioning reportable audits as prescribed in DCMA-MAN 2201-04. The appropriate CMO Contracts Director or CACO/DACO Division Team Supervisor must verify the CO 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 "DCMAI Audit Follow Up of Non-DCAA Audit Product" Business Practice located on the Resource Page.

(b) Overhead Negotiations eTool. This eTool tracks the negotiation activity of FICR process.

(c) Form 1 eTool. Tracks Form 1s issued by DCAA.

(d) 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 DCMA Memorandum 15-031, "Populating and Maintaining Data in Contract Business Analysis Repository," TAB A.

(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. DEFINITIONS.

Claim. 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.”

COFD. 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.

Directly associated cost. 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.

FICR File. A repository for the documents the CO relied upon to establish the FICR.

DCAA Form 1. 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. Per 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.

Fiscal Year End. 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.

Host Nation. 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.

GLOSSARY

G.2. ACRONYMS.

ACO	administrative contracting officer
BoR	Boards of Review
CACO	corporate administrative contracting officer
CAFU	Contract Audit Follow-Up
CDRC	Contract Disputes Resolution Center
CDA	Contract Dispute Act
CMO	Contract Management Office
CO	contracting officer
COFD	contracting officer's final decision
DACO	divisional administrative contracting officer
DCAA	Defense Contract Audit Agency
DCAA CAM	DCAA Contract Audit Manual
DCAA Form 1	Notice of Contract Costs Suspended and/or Disallowed
DCMA-INST	DCMA Instruction
DCMA-MAN	DCMA Manual
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulation
FICR	final indirect cost rate
IAW	in accordance with
IHO	intermediate home office
MFR	memorandum for record
PCO	procuring contracting officer
PNO	prenegotiation objectives
PNOM	Prenegotiation Objectives Memorandum
PNM	Price Negotiation Memorandum

REFERENCES

Contract Disputes Act, March 1, 1979
DCAA Manual 7640.1, "DCAA Contract Audit Manual," July 2021
DCMA Instruction 134, "Boards of Review," October 15, 2012, as amended
DCMA Manual 2201-01, "Forward Pricing Rates," February 14, 2019, as amended
DCMA Manual 2201-04, "Contract Audit Follow-Up," March 3, 2019
DCMA Manual 2401-01, "Negotiation Intelligence Procedures," December 19, 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," April 13, 2018
DCMA Manual 4501-04, Volume 1: "Records and Information Program," April 16, 2021
DCMA Memorandum 15-031, "Populating and Maintaining Data in Contract Business Analysis Repository," February 12, 2015
Defense Procurement and Acquisition Policy Memorandum #212-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
Federal Acquisition Regulation (FAR), current edition