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June 30, 2016

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
ASSISTANT DIRECTORS, HQ, DCAA

SUBJECT: Audit Alert on Handling Incurred Cost Proposals Using a Blending Approach of Compensation Caps

Many contractors have recently submitted, or will soon be submitting, their Fiscal Year 2015 incurred cost proposals. Frequently Asked Question No. 7 of MRD 16-PSP-005(R), dated February 19, 2016, provided direction on handling new and existing incurred cost proposals that include blending of compensation caps without an advance agreement. This audit alert is to clarify and expand on that guidance to ensure that audit teams properly handle incurred cost submissions.

How do I handle Incurred Cost Proposals I receive that use a blending approach?

When the audit team receives an incurred cost proposal that includes a blending approach of the compensation caps, the audit team should not wait for a signed advance agreement to do the adequacy assessment of the proposal. Upon receipt of the proposal, they should assess it for adequacy, and work through the adequacy process to obtain an adequate proposal from the contractor. Upon receipt of the proposal, the audit team should also touch base with the Administrative Contracting Officer (ACO) to notify them that the submission includes a blending approach. In some cases, the audit team may already be engaged with the ACO on working to execute an advance agreement, but if not, the audit team should notify the ACO that an advance agreement is needed in accordance with the DDP Memorandum, "Use of Blended Rates to Implement Multiple Compensation Caps" (October 25, 2014). The audit team should offer to support the ACO's execution of an advance agreement by performing a non-audit service under Activity Code 23600 (discussed in detail in MRD 16-PSP-005(R)).

How do I proceed after performing the adequacy review of the incurred cost proposal?

If the audit team determines that the submission is inadequate in accordance with FAR 52.216-7(d), the audit team should issue an inadequacy letter to the contractor. Additionally, if there is no executed advance agreement, the letter should include the statement, "The proposal includes a blending approach of compensation caps without an advance agreement. An advance agreement is required when a blending approach is used; therefore, the submission should not be resubmitted until such advance agreement is signed."

When the proposal is determined adequate and there is no executed advance agreement, the audit team should return the proposal and require the contractor to resubmit the proposal only after executing an advance agreement with the ACO. When drafting the letter to the contractor, remember that the advance agreement has no bearing on determining the adequacy or inadequacy of the proposal in accordance with FAR 52.216-7(d); however, the advance agreement is required when a blending approach is used. Prior to returning an adequate submission to the contractor, audit teams

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should use their judgment in determining if officially returning the proposal is necessary given the status of the advance agreement (e.g., if DCAA has already provided the non-audit service and DCMA is in the final stages of finalizing the advance agreement, returning the proposal may not be necessary.)

What do I input into DMIS when a proposal is received using a blending approach?

When a proposal is received using a blending approach, designate "P" in the DMIS proposal status field and enter "blended" and "the date of notification to DCMA" (e.g., Blended March 14, 2016) in the Agency Wildcard Field 1. After performance of the adequacy review, if it is determined to be inadequate, and/or if the advance agreement is still not executed, the audit team should return the proposal, designate "R" in the DMIS proposal status field, and update the Agency Wildcard Field 1 to include the words "Returned" or "Inadequate." Returned should be used when the proposal is adequate in accordance with FAR 52.216-7(d), but no advance agreement has been executed. Inadequate should be used when the proposal is inadequate in accordance with FAR 52.216-7(d), and no advance agreement has been executed. Once the advance agreement has been executed, the language in the Agency Wildcard Field 1 should be removed. These inputs will allow us to identify at an Agency level where negotiations of advance agreements are required for existing contractor proposals. We will share this information with DCMA.

Use of Activity Code 23600 for Non-Audit Service on Proposed Advance Agreement

As a reminder, DCAA will provide a non-audit service on the proposed advance agreement. This service represents the effort expended to identify any processes that could result in the inclusion of compensation costs exceeding the allowable cap, and to confirm the terms require that the contractor maintain auditable data necessary to support the performance of our future audit responsibilities. This service is performed under Activity Code 23600, Advance Agreement – Blended Compensation, and filed in Livelink when completed. Remember this is a non-audit service, and no actual testing should take place during the review of the advance agreement. Our testing will take place during the forward pricing and incurred cost audits that implement this blending approach.

Questions and Further Information

The Checklist for Determining Adequacy of Contractor Incurred Cost Proposals has been updated to bring awareness to this process. FAO personnel should direct questions to their regional points-of-contact. Regional personnel with questions should contact Pricing and Special Projects Division at 703.767.3290 or e-mail at DCAA-PSP@dcaa.mil.

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