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Department of Defense
DIRECTIVE

AD-A272 488



February 12, 1988
NUMBER 7640.2

IG, DoD

2

SUBJECT: Policy for Followup on Contract Audit Reports

- References:
- (a) DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports," July 18, 1986 (hereby canceled)
 - (b) Office of Management and Budget (OMB) Circular A-50 (Revised), "Audit Followup," September 29, 1982
 - (c) DoD Directive 7650.3, "Followup on General Accounting Office, DoD Inspector General, Internal Audit and Internal Review Reports," March 19, 1985
 - (d) DoD Instruction 7600.2, "Audit Policies," January 10, 1985
 - (e) through (j), see enclosure 1

A. REISSUANCE AND PURPOSE

This Directive:

- 1. Reissues reference (a) to clarify responsibilities, reporting requirements, and followup procedures on contract and grant audits conducted by the Defense Contract Audit Agency (DCAA) and the Army Corps of Engineers.
- 2. Implements reference (b).

B. APPLICABILITY AND SCOPE

- 1. This Directive applies to the Office of the Secretary of Defense (OSD), the Military Departments, and the Defense Agencies (hereafter referred to collectively as "DoD Components").
- 2. Its provisions do not apply to the reports of the General Accounting Office (GAO), the Inspector General, Department of Defense (IG, DoD), and other DoD internal audit organizations. Followup policies and procedures for the reports of those organizations are contained in reference (c); however, the IG, DoD, and contract audit followup officials may formulate special procedures for followup on defective pricing reports of the IG, DoD, and the GAO.

C. DEFINITIONS

Terms used in this Directive are defined in enclosure 2.

D. POLICY

- 1. The responsibility for reaching agreement with the contractor is the contracting officer's, and he or she has wide latitude and discretion in that regard. The Department of Defense recognizes, under OMB Circular A-50 and DoD Instruction 7600.2 (references (b) and (d)), the need for contracting officers

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to give full consideration to contract audit advice and to document the disposition of audit recommendations. The contract audit followup system shall be structured in consonance with the independent, decision-making role of the contracting officer and the financial advisory role of the contract auditor.

2. To accommodate the variances between contract audit reports and internal audit reports, this Directive prescribes special guidance for contract audit resolution, disposition, tracking, and followup status reporting.

3. In accordance with reference (b), the resolution and disposition of all contract audit reports shall be consistent with legal statutes, regulations, and DoD policy.

E. RESPONSIBILITIES

1. The Inspector General, DoD, (IG, DoD) shall develop contract audit followup policy, and shall monitor, coordinate, and evaluate contract audit followup systems in the Department of Defense. In discharging this responsibility, the IG shall:

a. Develop policy and provide guidance to DoD Components on matters covered under this Directive.

b. Monitor and evaluate program performance to ensure that the DoD Components and contract audit organizations effectively carry out their contract audit followup responsibilities in accordance with this Directive.

c. Identify cases or areas where contract audit followup procedures can be improved and recommend appropriate corrective action to the DoD Component head concerned.

d. Provide periodic reports on the status of DoD contract audit followup efforts, including those required by OMB Circular A-50 (reference (b)), to the Secretary of Defense.

2. The Secretaries of the Military Departments and the Directors of the Defense Agencies shall:

a. Designate a contract audit followup official to manage their Component's contract audit followup program.

b. Establish procedures as prescribed by Federal Acquisition Regulation (FAR) 15.807 (reference (e)), whereby contracting officers shall fully consider contract audit advice in the course of determining pre-negotiation positions that are subject to DoD Component review and clearance processes.

c. Direct periodic evaluations of their Component's followup systems to determine whether the systems are adequate and result in timely, appropriate resolution and disposition of audit reports.

d. Ensure that performance appraisals of appropriate acquisition officials reflect their effectiveness in resolving and dispositioning audit findings and recommendations in a timely manner, while fully protecting the Government's interest.

e. Establish procedures for maintenance of up-to-date records on all applicable contract audit reports covered in section B., enclosure 4, of this Directive from receipt through disposition. For open reports, this includes written milestone plans for resolution and disposition as required by the Status Report on Specified Contract Audit Reports, attachment 1 to enclosure 3.

f. Establish procedures to monitor and ensure the proper, timely resolution and disposition of contract audit reports.

g. Establish procedures to ensure that the DoD Component's semiannual contract audit followup status report is prepared and submitted to the OIG in accordance with the procedures in subsection F.3., below, and enclosure 3 of this Directive.

h. Ensure that acquisition personnel in their Component are adequately trained in the utilization of contract audit reports and the requirements of the contract audit followup program.

3. The Director, Defense Contract Audit Agency (DCAA), and Heads of Other Contract Audit Organizations shall:

a. Provide timely and complete responses to any contracting officer or review official who requests factual information or further audit opinions regarding the audit issues under review.

b. Provide timely and complete support to the IG and any internal audit organization reviewing a DoD Component's contract audit followup system, in accordance with DoD Instruction 7600.2 (reference (d)).

c. Utilize the feedback provided by the contracting officials, including final disposition and negotiating memoranda, to analyze and improve audit procedures and practices.

d. Identify those contract audit reports that are reportable under subsection F.3., below, to the applicable DoD Component at the time of issuance, and provide a summary record of all such reports to the DoD Components at least semiannually. The record shall include the activity address numbers (Appendix N of DFARS (reference (f))) code for each report issued.

e. Forward all audit reports on auditor-determined, final indirect cost rates to the cognizant administrative contracting officer for resolution when agreement cannot be reached with the contractor.

F. PROCEDURES

1. General. Contracting officers and acquisition management officials shall pursue timely, proper resolution and disposition of contract audit reports. Resolution of contract audit reports, other than preawards, is required by P.L. 96-304 (reference (g)), as well as by OMB Circular A-50 (reference (b)), within 6 months of report issuance. Disposition should take place as soon as possible after resolution.

2. Tracking Requirements

a. All contract audit reports are to be tracked; however, only the reports specified in paragraph F.3.a., below, are to be reported. For preaward contract audits, specified in paragraph F.3.b., below, tracking may be accomplished using records maintained in official contract files.

b. Individual procurement or contract administration offices shall track and report the status of all specified contract audit reports from the date of receipt through final disposition. This information shall be maintained on a current basis and shall serve as the source document for followup status reports. Although the audit organization shall identify reportable contract audits, the ultimate decision resides with the procurement or contract administration office. Audit reports shall be dropped from the tracking system in the reporting period following closure.

3. Reporting Requirements. The DoD acquisition and contract administration organizations shall maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition. For auditor-determined final indirect cost rate reports, a report is considered received for followup tracking purposes when it is received by the cognizant Administrative Contracting Officer (ACO) for resolution and disposition.

a. Reportable Audits include:

(1) Those containing findings and recommendations, whether or not the findings are qualified, covering estimating system surveys, accounting system reviews, defective pricing reviews, cost accounting standards (CAS) noncompliance issues, including CAS disclosure statements if they contain noncompliance issues.

(2) Those covering internal controls, operations audits, incurred costs, settlement of final indirect cost rates, final pricing submissions, termination settlement proposals, equitable adjustment claims, hardship claims, and escalation claims, if reported costs or rates questioned or qualified equal \$100,000 or more.

(3) Those final indirect cost rates where the auditor cannot reach an agreement with the contractor and forwards the audit report to the cognizant ACO for final decision.

b. Nonreportable Audits. Reports covering preaward proposals; forward pricing labor, overhead, and other advance rate proposals; progress payments; preaward surveys; proposals for change orders or modifications; assist audits; and closing statements are not to be reported. Should such audits contain reportable findings and recommendations, they are not to be treated as a reportable report; however, if deemed appropriate, the contracting officer should request the DCAA to issue a separate audit report addressing the reportable issues in detail. Reports containing only positive findings and recommendations, such as recommending that a contractor's proposed cost accounting standards change be approved, are not to be reported. Any interim report that will be incorporated into a future report shall not be reported. Final indirect cost audits that are auditor-determined are not to be reported if the auditor is successful in reaching an agreement on the rate(s) with the contractor.

c. The DCAA shall provide to the Military Departments and the Defense Logistics Agency (DLA) listings of all reportable contract audit reports issued during the 6-month periods ending February 28 and August 31. Such data shall be furnished not later than 21 days after the close of each period.

d. The DoD Components shall submit reports on the status of reportable contract audits semiannually to the IG, DoD, within 30 calendar days of the end of the 6-month periods ending March 31 and September 30. The required formats are on attachments 1 and 2 to enclosure 3. These reports shall include the following data:

(1) For open reports. The report number, report date, contractor name, type of audit, costs questioned or cost avoidance, Armed Services Board of Contract Appeals (ASBCA) docket number (U.S. Claims Court case number) when the report is in litigation, date of request by an investigative agency for deferral of action on a report (when applicable), whether the report is resolved or unresolved, resolution target date, and disposition target date (attachment 1, enclosure 3).

(2) For reports closed during the reporting period. The report number, report date, contractor name, type of audit, date of disposition, costs questioned or potential cost avoidance, and costs questioned or avoidance sustained. Costs questioned and sustained shall be reported as zero when a report is superseded, replaced, or incorporated into a new report. In such cases, the Date of Disposition column should show the new report number with the date of the new report (attachment 2, enclosure 3).

4. Resolution of Contract Audit Reports

a. The DoD Component procedures for documenting and reviewing proposed prenegotiation objectives shall provide the independent review for internal control purposes prescribed by OMB Circular A-50 (reference (b)). For most contract audits reports, the contracting officer should obtain contractor comments, and such technical advice deemed necessary, prior to formulating a prenegotiation position. The additional information shall be shared with the auditor, as appropriate. If additional audit effort is required because of data presented by the contractor, the contracting officer shall promptly request such a review, and the audit organization shall give priority to providing the necessary additional audit support. If no additional audit effort is deemed necessary, the contracting officer shall communicate with the auditor on the proposed disposition, as necessary, to reach a fully informed decision. In documenting his or her prenegotiation position, the contracting officer should indicate whether the audit recommendations were accepted or, if not, whether the auditor has revised them. When the contracting officer disagrees with the audit position, the contracting officer's prenegotiation documentation should include the rationale for not accepting the audit advice. The post-negotiation documentation should include a summary of the field pricing report recommendations and the reasons for any pertinent variances from those recommendations.

b. For auditor-determined indirect cost rates, the auditor shall seek agreement with the contractor upon completion of the audit. If agreement is reached, the contractor and auditor execute a written understanding setting forth the final rates. If agreement is not reached, the auditor shall issue a notice of costs suspended and/or disapproved, and advise the contractor of its right to submit a claim to the ACO for any disapproved costs. If the contractor submits a written objection to the ACO, the ACO may communicate further with the contractor in order to reach an agreement. If the ACO disagrees with the audit recommendations, he/she complies with the procedures prescribed by his/her DoD Component for documentation and review prior to disposition. If the ACO agrees with the audit recommendations, he/she issues a final decision, after complying with the procedures prescribed by his/her DoD Component for documentation and review.

5. Notification of Final Disposition of Contract Audit Reports

a. Explicit and timely documentation and feedback on the final disposition of audit reports are essential. Therefore, the contracting officer shall promptly prepare a memorandum covering the disposition of all reports. The memorandum shall discuss the disposition of all recommendations and questioned and/or qualified amounts, including the underlying rationale for such dispositions. A copy of the memorandum shall be provided to the cognizant contract auditor before a report may be closed.

b. Existing feedback mechanisms, such as a price negotiation memorandum, DAR 3-811(a) (reference (h)), DFARS 15.808 (reference (f)), and FAR 15.808 (a) (reference (e)), or a written overhead negotiation memorandum, DAR 3-705(b)(5) (reference (h)), DFARS 42.706 (reference (f)) and FAR 42-705-1(b)(5) (reference (e)) should be used, when applicable. For all other actions, a similar document shall be prepared. To ensure that the final disposition of all audit reports is properly accounted for, the procurement or administrative contracting officer shall notify the cognizant audit office in writing of the cancellation of any acquisition action and of any unsuccessful offerors not receiving award of the contract or grant for which an audit report was issued.

6. Recovery of Funds. Policies regarding the DoD credit management and debt collection program are contained in the DoD Directive 7045.13 (reference (i)), Appendix E of the DAR (reference (h)), DFARS 32.6 (reference (f)) and FAR 32.6 (reference (e)) for contract debts. Any amount due the Government as a result of a contract audit is to be determined by the contracting officer negotiating a settlement with the contractor or by the contracting officer issuing a unilateral decision when negotiations prove fruitless. Upon completion of either action, a prompt demand for payment in writing should be made by the contracting officer citing the amount due with a copy of the demand provided to the payment office cited in the contract. The demand should include notice that any amount not paid within 30 days from the date of the demand shall accrue interest from the date of the demand at the prevailing Treasury Rate (Parts 32 of FAR and DFARS (references (e) and (f))) provide specific instructions for demand notices). General ledger accounts for recording accounts receivable and collections are detailed in Chapter 33 and Appendix B of DoD 7220.9-M (reference (j)).

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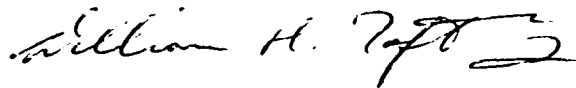
7. Coordination with Other Agencies. The cognizant contracting office responsible for acting on contract audit reports that affect contracts of other Government Agencies shall inform affected organizations of such actions.

G. INFORMATION REQUIREMENTS

The reporting requirements of this Directive have been assigned Report Control Symbol DD-IG(SA)1580.

H. EFFECTIVE DATE AND IMPLEMENTATION

This Directive is effective immediately. Forward one copy of implementing documents to the Inspector General, Department of Defense, within 120 days.



William H. Taft, IV
Deputy Secretary of Defense

Enclosures - 4

1. References
2. Definitions
3. Followup Status Reports
4. Contract Audit Reports Subject to Tracking, Reporting, Resolution, Disposition, and Notification Requirements

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Accession For	
NTIS	CRA&I <input checked="" type="checkbox"/>
DTIC	TAB <input type="checkbox"/>
Unannounced <input type="checkbox"/>	
Justification	
By <i>form 50</i>	
Distribution /	
Availability Codes	
Dist	Avail and/or Special
A-1	

REFERENCES, continued

- (e) Federal Acquisition Regulation (FAR)
- (f) DoD FAR Supplement (DFARS)
- (g) Public Law 96-304, "Supplemental Appropriations and Rescissions Act of 1980," July 8, 1980
- (h) Defense Acquisition Regulation (DAR)
- (i) DoD Directive 7045.13, "DoD Credit Management and Debt Collection Program," October 31, 1986
- (j) DoD 7220.9-M, "Department of Defense Accounting Manual," October 1983, authorized by DoD Instruction 7220.9, October 22, 1981

DEFINITIONS

1. Adverse Opinion Report. An audit report containing the statement that the contractor's proposal is not acceptable as a basis for negotiation of a price.
2. Closed Audit Report. An audit report that has been dispositioned by the contracting officer and closed for followup tracking purposes. See the definition for Disposition of Contract Audit Reports at 7, below.
3. Contract Audit Report. The contract auditor's written advice to a contracting officer advocating specific action on the part of the contracting officer or contractor and/or including highly qualified or adverse opinion information. An audit report could include amounts questioned or disapproved, exceptions to a contractor's system or operations (usually expressed in terms of cost avoidance), recommended price adjustments, or notification of a contractor's non-compliance with cost accounting standards.
4. Costs Questioned. a. The amount questioned in the audit report that the reporting contracting officer or auditor has responsibility and authority to disposition. Audit reports on final indirect cost rates (overhead) will typically have costs questioned relating to corporate allocations and costs questioned relating to divisional expenses. The divisional ACO should list only the amount questioned pertaining to division expenses which he or she is responsible for negotiating, and the corporate ACO should be reporting the costs questioned at the corporate level which he or she is responsible for negotiating. Each contracting officer should list the total amount questioned subject to negotiation AT THAT LEVEL, regardless of contract mix or percentage of commercial business. b. All costs set aside as "unsupported," qualified and/or adverse opinion amounts unless such amounts are disclaimed by the auditor because of requested assist audits or need for technical evaluation. Such amounts are not to be reported by the contracting officer until the assist audit and/or technical evaluation is incorporated by a supplemental report. At time of receipt, the amount questioned and the report date shall be revised for correction in the next semiannual report. c. Costs monetized as a result of a technical evaluation that are INCORPORATED into the audit report.
5. Costs Questioned Sustained. That portion of costs questioned and/or qualified by the auditor upheld as a result of actions taken by either the contractor or the contracting officer.
6. Disclaimed Opinion Report. Any audit denying the validity of a proposal when the scope of audit was so restricted that an audit opinion cannot be justified.
7. Disposition of Contract Audit Reports. Contract audit report disposition is achieved when: a. The contractor implements the audit recommendations or the contracting officer's decision; or b. The contracting officer negotiates a settlement with the contractor and a contractual document has been executed; or c. The contracting officer issues a final decision pursuant to the Disputes Clause, and 90 days elapse without contractor appeal to the Armed Services Board of Contract Appeals (ASBCA). Should the contractor appeal to the Claims Court within the 12 months after final decision, the audit must be

reinstated as an open report in litigation; or d. A decision has been rendered on an appeal made to the ASBCA or U.S. Claims Court and any corrective actions directed by the Board or Court have been completed and a contractual document has been executed; or e. Audit reports have been superseded by, or incorporated into, a subsequent report; or f. Any corrective actions deemed necessary by the contracting officer have been taken, so that no further actions can be reasonably anticipated.

In the case of divisional overhead audit reports, such reports may be considered dispositioned when the contracting officer has negotiated all local issues with the contractor and a written agreement detailing the results of the negotiations has been signed by both the contracting officer and the contractor and distribution has been made to DCAA. A cost accounting standard noncompliance report is dispositioned when the audit report on the related cost impact statement is received by the contracting officer, when required.

8. Highly Qualified Opinion Report. Qualified audit reports vary according to circumstances, but typically indicate a significant inadequacy in the cost or pricing data, denial of access to records, or noncompliance with cost accounting standards or acquisition regulation. For the purposes of followup coverage under this Directive, the audit report must specifically say that the results of audit are HIGHLY qualified.

9. Litigation. An audit report is considered to be in litigation any time an appeal has been filed with the ASBCA or any court concerning an audit recommendation and/or qualification identified in the audit report for a specific contractor. An audit report is also in litigation whenever the Government appeals a decision of the ASBCA or U.S. Claims Court, or there is other ongoing judicial action as a result of a contract audit.

10. Open Audit Report. An audit report that has not been dispositioned.

11. Overaged. An audit report that has not been dispositioned and is over 12 months old (from date of issuance) on the "as of" date of the status report.

12. Resolution. a. For reportable audits, the point at which the auditor and the contracting officer agree on the action to be taken on audit report findings and recommendations and/or qualifications; or, in the event of disagreement, when the contracting officer determines a course of action after following the DoD Component prenegotiation documentation and review procedures. Resolution must be supported by specific written documentation in the file. b. In the case of auditor-determined final indirect cost rates, resolution is achieved when an agreement is reached between the auditor and the contractor, or when agreement cannot be reached, a decision is rendered by the cognizant ACO after obtaining additional review, if required. c. For preaward audits, the point at which agreement is reached, a proposed negotiation objective is modified during review, a contract price negotiated, or proposed award canceled, whichever occurs first.

FOLLOWUP STATUS REPORTS
RCS DD-IG(SA)1580

A. The reports shall provide the information detailed in paragraph F.3.d. of this Directive. All listed reports shall be tracked and reported through final disposition.

B. Each acquisition and contract administration contract audit followup official shall submit a semiannual status report in the attached format. Summary reports for DoD Components shall be submitted to the IG. The reports shall cover the semiannual periods ending March 31 and September 30 and shall be submitted within 30 calendar days after the end of the period. Items shall be removed from the tracking and reporting system in the period following that in which they appeared on the status report as being closed.

C. Each reporting activity shall cite the appropriate activity address number on the line requiring DoD Component. The activity address numbers are listed in Appendix N of DAR (reference (g)). Activities not assigned a number shall report by organization and address. Components reporting via an automated system may satisfy this requirement using their own location codes as long as an explanation is furnished with the submission.

Attachments - 3

1. Status Report on Specified Contract Audit Reports--Open Reports
2. Status Report on Specified Contract Audit Reports--Reports Closed During Period
3. Codes for Type of Audit

STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
(Report Control Symbol DD-IG(SA)1580)

OPEN REPORTS

For period ending _____
DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit	Costs		In Litigation	Resolved or Unresolved	Resolution Target Date	Disposition Target Date
				Questioned or Cost	Avoidance				

A. Overaged reports
(over 12 months
old)

B. Reports 6-12 months
old

C. Reports less than
6 months old

D. Reports in
litigation

E. Reports involved
in criminal investigation 2/

- 1/ Use types or codes listed on Attachment 3
2/ If the investigative organization has requested deferral of resolution or disposition
3/ Docket/Case No. or no (N)
4/ Date of resolution or (U) if unresolved
5/ Year, month, day

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STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
 (Report Control Symbol DD-IG(SA)1580)

REPORTS CLOSED DURING PERIOD

For period ending _____
 DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit	Date of Disposition	Costs	
					Questioned or Cost Avoidance	Costs Sustained/ Avoided

A. Reports listed as
 overaged in prior
 report

B. Other reports closed
 during period

- 1/ Year, month, day
 2/ Use types or codes listed on Attachment 3

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<u>Code</u>	<u>Type of Audit</u>
A	Estimating System Survey
B	Accounting System Review
C*	Internal Control Review
D	Defective Pricing Review
E	Cost Accounting Standards Noncompliance
F*	Operations Audit
G*	Incurred Costs
H*	Settlement of Final Indirect Cost Rate
I*	Final Pricing
J*	Terminations
K*	Equitable Adjustment Claims
L*	Hardship Claims
M*	Escalation Claims

*Reported costs or rates questioned and/or qualified must equal \$100,000 or more.

CONTRACT AUDIT REPORTS SUBJECT TO TRACKING, REPORTING,
RESOLUTION, DISPOSITION AND NOTIFICATION REQUIREMENTS

A. Reports Subject to Tracking

All contract audit reports. (For preaward contract audits, including change order proposals, tracking may be accomplished using records maintained in official contract files.)

B. Reports Subject to Tracking and Reporting Requirements of Subsections F.2. and F.3., Basic Directive:

1. All contract audit reports with findings and recommendations addressing:

- a. Estimating system surveys
- b. Accounting system reviews
- c. Defective pricing reviews
- d. Cost accounting standards noncompliance reviews

2. Reports that have findings, recommendations, and costs questioned and/or qualified of \$100,000 or more, and that address:

- a. Incurred costs
- b. Settlement of indirect cost rates
- c. Final pricing submissions
- d. Termination settlement proposals
- e. Equitable adjustment claims
- f. Hardship claims
- g. Escalation claims
- h. Internal controls
- i. Operations reviews

3. All auditor-determined, final indirect cost rate disputes that are forwarded to the cognizant ACO for decision.

C. Reports Subject to Resolution

All contract audit reports.

SUPPLEMENTARY

INFORMATION

DEPARTMENT OF DEFENSE
DIRECTIVES SYSTEM TRANSMITTAL

ERRATA

NUMBER 7640.2, Change 1	DATE August 16, 1995	DISTRIBUTION 7000 Series
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ATTACHMENTS

11 Pages

INSTRUCTIONS FOR RECIPIENTS

The following pen and page changes to DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports," February 12, 1988, are authorized:

PEN CHANGES

Page 1, references

(c), line 3. Change "March 19, 1985" to "September 5, 1989"

(d), line 1. Change "January 10, 1985" to "February 2, 1991"

Subsection A.1., Line 3. Delete "." and add ", and Contractor Insurance/Pension reviews conducted by the Defense Logistics Agency (DLA)."

Page 2, subsection E.1., line 1. After "(IG, DoD)" insert ", in accordance with DoD Directive 5106.1 (reference (e))."

Page 3-1, section C.

Line 1. After "number" insert "or DoD Activity Address Code (DODAAC)"

Line 3. Change "N of DAR" to "G of DFARS"

PAGE CHANGES

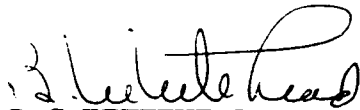
Remove: Pages 3 through 6, 1-1 through 2-2, 3-1-1 through 4-1

Insert: Attached replacement pages

Changes are indicated by marginal asterisks and change bars.

EFFECTIVE DATE

The above changes are effective immediately.


B. C. WHITEHEAD
Director
Correspondence and Directive

WHEN PRESCRIBED ACTION HAS BEEN TAKEN, THIS TRANSMITTAL SHOULD BE FILED WITH THE BASIC DOCUMENT

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e. Establish procedures for maintenance of up-to-date records on all applicable contract audit reports covered in section B., enclosure 4, of this Directive from receipt through disposition. For open reports, this includes written milestone plans for resolution and disposition as required by the Status Report on Specified Contract Audit Reports, attachment 1 to enclosure 3.

f. Establish procedures to monitor and ensure the proper, timely resolution and disposition of contract audit reports.

g. Establish procedures to ensure that the DoD Component's semiannual contract audit followup status report is prepared and submitted to the OIG in accordance with the procedures in subsection F.3., below, and enclosure 3 of this Directive.

h. Ensure that acquisition personnel in their Component are adequately trained in the utilization of contract audit reports and the requirements of the contract audit followup program.

3. The Director, Defense Contract Audit Agency (DCAA), and Heads of Other Contract Audit Organizations shall:

a. Provide timely and complete responses to any contracting officer or review official who requests factual information or further audit opinions regarding the audit issues under review.

b. Provide timely and complete support to the IG and any internal audit organization reviewing a DoD Component's contract audit followup system, in accordance with DoD Instruction 7600.2 (reference (d)).

c. Utilize the feedback provided by the contracting officials, including final disposition and negotiating memoranda, to analyze and improve audit procedures and practices.

d. Identify those contract audit reports that are reportable under subsection F.3., below, to the applicable DoD Component in a monthly electronic or hard copy report. The report shall include the activity address number (Appendix G of DFARS (reference (g)) or the DoD Activity Address Code (DODAAC) for each report issued.

e. Forward all audit reports on auditor-determined, final indirect cost rates to the cognizant administrative contracting officer for resolution and disposition when agreement cannot be reached with the contractor.

4. The Director, Defense Logistics Agency (DLA) shall identify to the DoD Components those Contractor Insurance/Pension Reviews (CIPRs) that are reportable under subsection F.3., below.

F. PROCEDURES

1. General. Contracting officers and acquisition management officials shall pursue timely, proper resolution and disposition of contract audit reports. Resolution of contract audit reports, other than preawards, is required by P.L. 96-527 (reference (h)), as well as by OMB Circular A-50 (reference (b)), within 6 months of report issuance. OMB Circular A-50, paragraph 10 specifically exempts preaward audits from the resolution time limits and reporting requirements. Disposition should take place as soon as possible after resolution.

2. Tracking Requirements

a. All contract audit reports are to be tracked; however, only the reports specified in paragraph F.3.a., below, are to be reported. For preaward contract audits, specified in paragraph F.3.b., below, tracking may be accomplished using records maintained in official contract files.

b. Individual procurement or contract administration offices shall track and report the status of all specified contract audit reports from the date of receipt through final disposition. This information shall be maintained on a current basis and shall serve as the source document for followup status reports. Although the audit organization shall identify reportable contract audits, the procurement or contract administration office is ultimately responsible for reporting all audits meeting the criteria identified in paragraph F.3.a., below. Audit reports shall be dropped from the tracking system in the reporting period following closure.

3. Reporting Requirements. The DoD acquisition and contract administration organizations shall maintain timely and complete information regarding the status of reportable contract audit reports from the time the report is received through final disposition. For auditor-determined final indirect cost rate reports, a report is considered received for followup tracking purposes when it is received by the cognizant Administrative Contracting Officer (ACO) for resolution and disposition.

a. Reportable Audits include:

(1) Those containing findings and recommendations, whether or not the findings are qualified, covering estimating system surveys, accounting and related internal control system reviews, defective pricing reviews, cost accounting standards (CAS) issues, and CAS cost impact statement reviews.

(2) Those covering operations reviews, incurred costs including final indirect cost rates or auditor-determined final indirect cost rates referred to the ACO for final decision, final pricing submissions, termination settlement proposals, and claims, if reported costs or rates questioned or qualified equal \$100,000 or more.

(3) Those CIPR reports issued by the DLA identifying instances of contractor noncompliance with CAS, and all CIPR reports with questioned or qualified costs of \$100,000 or more.

b. Nonreportable Audits. Reports covering preaward proposals; forward pricing labor, overhead, and other advance rate proposals; progress payments; preaward surveys; proposals for change orders or modifications; assist audits; and closing statements are not to be reported. Should such audits contain reportable findings and recommendations, they are not to be treated as a reportable audit; however, if deemed appropriate, the contracting officer should request the DCAA issue a separate audit report addressing the reportable issues in detail. Reports containing only positive findings and recommendations, such as recommending that a contractor's proposed cost accounting standards change be approved, are not to be reported. Any interim report that will be incorporated into a future report shall not be reported. Final indirect cost audits that are auditor-determined are not to be reported if the auditor is successful in reaching an agreement on the rate(s) with the contractor.

c. The DCAA shall provide to the applicable DoD Component a monthly electronic or hard copy report listing all reportable contract audit reports issued during the prior month. The report shall be furnished not later than 19 calendar days after the close of each month.

d. The DoD Components shall submit reports on the status of reportable contract audits and CIPRs semiannually to the IG, DoD, within 30 calendar days of the end of the 6-month periods ending March 31 and September 30. The required formats are on attachments 1 and 2 to enclosure 3. These reports shall include the following data:

(1) For open reports. The report number, report date, contractor name, type of audit, costs questioned or cost avoidance, Armed Services Board of Contract Appeals (ASBCA) docket number (United States Court of Federal Claims case number) when litigation involves matters identified in the report, whether the report is resolved or unresolved, resolution target date, and disposition target date. For superseding audits, also include the date of the original audit report that first identified any issue that is still open and included in the superseding or supplemental audit report. (attachment 1, enclosure 3)

(2) For reports closed during the reporting period. The report number, report date, contractor name, type of audit, date of disposition, costs questioned or potential cost avoidance, and costs questioned or avoidance sustained. Costs questioned and sustained shall be reported as zero when a report is superseded, replaced, or incorporated into a new report and the date of the superseding report will be shown in the Date of Disposition column. (attachment 2, enclosure 3)

4. Resolution of Contract Audit Reports

a. The DoD Component procedures for documenting and reviewing proposed prenegotiation objectives shall provide the independent review for internal control purposes prescribed by OMB Circular A-50 (reference (b)). For most contract audit reports, the contracting officer should obtain contractor comments, and such technical advice deemed necessary, prior to formulating a prenegotiation position. The additional information shall be shared with the auditor, as appropriate. If additional audit effort is required because of data presented by the contractor, the contracting officer shall promptly request such a review and the audit organization shall give priority to providing the necessary additional audit support. If no additional audit effort is deemed necessary, the contracting officer shall communicate with the auditor on the proposed disposition, as necessary, to reach a fully informed decision. Resolution must be supported by written documentation. In documenting his or her prenegotiation position, the contracting officer should indicate whether the audit recommendations were accepted or, if not, whether the auditor has revised them. When the contracting officer disagrees with the audit position, the contracting officer's prenegotiation documentation should include the rationale for not accepting the audit advice.

b. For auditor-determined indirect cost rates, the auditor shall seek agreement with the contractor upon completion of the audit. If agreement is reached, the contractor and auditor execute a written understanding setting forth the final rates. If agreement is not reached, the auditor shall issue a notice of costs suspended and/or disapproved, and advise the contractor of its right to submit a claim to the ACO for any disapproved costs. In accordance with FAR 42.705-2(v) (reference (f)) and DFARS 242.705-2(v) (reference (g)), the auditor shall then refer the matter to the ACO to resolve the disagreement. If the ACO disagrees with the audit recommendations, he/she complies with the procedures prescribed by his/her DoD Component for documentation and review prior to disposition. If the ACO agrees with the audit recommendations, he/she issues a final decision, after complying with the procedures prescribed by his/her DoD Component for documentation and review.

5. Notification of Final Disposition of Contract Audit Reports

a. Explicit and timely documentation and feedback on the final disposition of audit reports are essential. Therefore, the contracting officer shall promptly prepare a memorandum covering the disposition of all reports. The memorandum shall discuss the disposition of all recommendations and questioned and/or qualified amounts, including the underlying rationale for such dispositions. A copy of the memorandum shall be provided to the cognizant contract auditor when an audit report is closed.

b. Existing feedback mechanisms, such as a price negotiation memorandum, FAR 15.808(a) (reference (f)) and DFARS 15.808 (reference (g)), or negotiation memorandum of final indirect cost rates, FAR 42-705-1(b)(5)(iii) (reference (f)) should be used, when applicable, to notify the cognizant contract audit office of dispositioned audits. For all other actions, a similar document shall be prepared. To ensure that the final disposition of all audit reports is properly accounted for, the procurement or administrative contracting officer shall notify the cognizant audit office in writing of the cancellation of any acquisition action and of any unsuccessful offerors not receiving award of the contract or grant for which an audit report was issued.

6. Recovery of Funds. Policies regarding the collection of contract debts are contained in FAR 32.6 (reference (f)) and DFARS 232.6 (reference (g)) for contract debts. Any amount due the Government as a result of a contract audit is to be determined by the contracting officer negotiating a settlement with the contractor or by the contracting officer issuing a unilateral decision when negotiations are unsuccessful. Upon completion of either action, a written demand for payment should be made promptly by the contracting officer, citing the amount due, with a copy of the demand provided to the payment office cited in the contract. In accordance with FAR 32.610(b) (reference (f)), unless the contract is excluded under FAR 32.617, or the contract debt has been exempted from interest charges under agency procedures, the demand should include notification that any amounts not paid within 30 calendar days from the date of the demand will accrue interest from the date of the demand, or from any earlier date specified in the contract. FAR 32.610(b) (reference (f)) also states that the interest rate on these debts shall be the rate established by the Secretary of the Treasury, for the period affected, under Pub. L. 92-41. In the case of a debt arising from a price reduction for defective pricing or a CAS noncompliance, interest will continue to accrue from the date of overpayment by the Government until repayment by the contractor at the rate established by the Secretary of the Treasury, for the periods affected, under 26 U.S.C. 6621(a)(2) ((FAR 32.610(b) (reference (f)). In all cases, interest and penalties should not be included in bottom line settlements, but should be separately identified, through a specified date, for comptroller officials. In accordance with subsection B.8. of Chapter 33 of DoD 7220.9-M (reference (i)), when management determines that resources should be recovered from a defense contractor and the contracting officer issues a demand for payment, a receivable shall be recorded and collection action initiated as soon as possible. Also, in accordance with paragraph E.3.a. of Chapter 33 of reference (i), all interest and penalties assessed on contract debts are to be identified separately and deposited directly to the U.S. Treasury.

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REFERENCES, continued

- * (e) DoD Directive 5106.1, "Inspector General of the Department of
- * Defense," March 14, 1983
- * (f) Federal Acquisition Regulation (FAR)
- * (g) DoD FAR Supplement (DFARS)
- * (h) Public Law 96-527, "DoD Appropriation Act, 1981," December 15, 1980
- * (i) DoD 7220.9-M, "Department of Defense Accounting Manual," October
- * 1983, authorized by DoD Instruction 7220.9, October 22, 1981

DEFINITIONS

1. Adverse Opinion Report. An audit report containing the statement that the contractor's proposal is not acceptable as a basis for negotiation of a price.

2. Closed Audit Report. An audit report that has been dispositioned by the contracting officer and closed for followup tracking purposes. See the definition for Disposition of Contract Audit Reports at 7, below.

3. Contract Audit Report. The contract auditor's written advice to a contracting officer advocating specific action on the part of the contracting officer or contractor and/or including highly qualified or adverse opinion information. An audit report could include amounts questioned or disapproved, exceptions to a contractor's system or operations (usually expressed in terms of cost avoidance), recommended price adjustments, or notification of a contractor's noncompliance with cost accounting standards. Contract audit reports include CIPRs issued by the DLA. (See subparagraph F.3.a.(3) of this Directive.)

4. Costs Questioned. a. The amount questioned in the audit report that the reporting contracting officer or auditor has responsibility and authority to disposition. Audit reports on final indirect cost rates (overhead) will typically have costs questioned relating to corporate allocations and costs questioned relating to divisional expenses. The divisional ACO should report only the amount questioned pertaining to division expenses which he or she is responsible for negotiating, and the corporate ACO should report the costs questioned at the corporate level which he or she is responsible for negotiating. Each contracting officer should report the total amount questioned subject to negotiation AT THAT LEVEL, regardless of contract mix or percentage of commercial business. b. All costs set aside as "unsupported," qualified and/or adverse opinion amounts unless such amounts are disclaimed by the auditor because of requested assist audits or need for technical evaluation. Such amounts are not to be reported by the contracting officer until the assist audit and/or technical evaluation is incorporated by a supplemental report. At time of receipt, the amount questioned and the report date shall be revised for correction in the next semiannual report. c. Costs monetized as a result of a technical evaluation that are INCORPORATED into the audit report. d. For cost accounting standards cost impact audits, report the total amount of the cost impact estimated by the auditor.

5. Costs Questioned Sustained. That portion of costs questioned by the auditor upheld as a result of actions taken by either the contractor or the contracting officer.

6. Disclaimed Opinion Report. Any audit denying the validity of a proposal when the scope of audit was so restricted that an audit opinion cannot be justified.

7. Disposition of Contract Audit Reports. Contract audit report disposition is achieved when: a. The contractor implements the audit recommendations or the contracting officer's decision; or b. The contracting officer negotiates a settlement with the contractor and a contractual document has been executed; or c. The contracting officer issues a final decision pursuant to the Disputes Clause, and 90 days elapse without contractor appeal to the Armed Services Board of Contract Appeals (ASBCA). Should the contractor appeal to the United States Court of Federal Claims within 12 months after final decision, the audit must be reinstated as an open report in litigation; or

* d. A decision must be rendered on an appeal made to the ASBCA or United *
* States Court of Federal Claims and any corrective actions directed by the *
Board or Court have been completed and a contractual document has been
executed; or e. Audit reports have been superseded by, or incorporated into,
a subsequent report; or f. Any corrective actions deemed necessary by the
contracting officer have been taken, so that no further actions can be
reasonably anticipated.

* In addition, divisional overhead audit reports may be considered *
dispositioned when the contracting officer has negotiated all local issues
with the contractor and a written agreement detailing the results of the
negotiations has been signed by both the contracting officer and the
* contractor and distribution has been made to DCAA; and cost accounting *
* standard noncompliance reports may be dispositioned when the audit reports on *
* the related cost impact statements are received by the contracting officer, *
when required.

8. Highly Qualified Opinion Report. Qualified audit reports vary according
to circumstances, but typically indicate a significant inadequacy in the cost
or pricing data, denial of access to records, or noncompliance with cost
accounting standards or acquisition regulation. For the purposes of followup
coverage under this Directive, the audit report must specifically say that the
results of audit are HIGHLY qualified.

* 9. Litigation. An audit report is considered to be involved in litigation *
* any time an appeal has been filed with the ASBCA, the United States Court of *
* Federal Claims or any other Federal or State court concerning matters dealing *
* with a specific contractor identified in the report. An audit report is also *
* considered to be involved in litigation whenever the Government appeals a *
* decision of the ASBCA, the United States Court of Federal Claims, or any other *
* court, or there is other ongoing judicial action that has bearing on matters *
* or issues identified in the report. *

10. Open Audit Report. An audit report that has not been dispositioned.

* 11. Original Audit Report Date. The date of the original audit report that *
* first identified any issue that is still open and included in a superseding or *
* supplemental audit report. *

* 12. Overage Audit Report. An audit report that has not been dispositioned *
* and is over 12 months old (from date of issuance) on the closing date of the *
* semiannual reporting periods ending March 31 and September 30. *

* 13. Reports Involved in Investigation. An audit report is considered to be *
* involved in an investigation when deferral of resolution or disposition action *
* has been requested by an investigative agency of the U.S. Government. *

* 14. Resolution. a. The point at which the auditor and the contracting *
officer agree on the action to be taken on audit report findings and
recommendations and/or qualifications; or, in the event of disagreement, when
the contracting officer determines a course of action after following the DoD
Component prenegotiation documentation and review procedures. b. In the case
of auditor-determined final indirect cost rates, resolution is achieved when
an agreement is reached between the auditor and the contractor, or when
agreement cannot be reached, a decision is rendered by the cognizant ACO after
obtaining additional review, if required. c. For preaward audits, the point
at which agreement is reached, a proposed negotiation objective is modified
during review, a contract price negotiated, or proposed award canceled,
* whichever occurs first. Resolution must be supported by specific written *
* documentation in the file. *

STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
(Report Control Symbol DD-IG(SA)1580)

OPEN REPORTS

For period ending _____
DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit 1/	Costs Questioned or Cost Avoidance	In Litigation 3/	Resolved or Unresolved 4/	Resolution Target Date 5/	Disposition Target Date 5/	Audit Report Date 6/	Original *
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- A. Overage reports (over 12 months old)
- B. Reports 6-12 months old
- C. Reports less than 6 months old
- D. Reports in litigation
- E. Reports involved in criminal investigation 2/

- 1/ Use types or codes listed on Attachment 3
- 2/ If the investigative organization has requested deferral of resolution or disposition
- 3/ Docket/Case No. or no (N)
- 4/ Date of resolution or (U) if unresolved
- 5/ Month, day, year
- 5/ Complete for superseding reports

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STATUS REPORT ON SPECIFIED CONTRACT AUDIT REPORTS
(Report Control Symbol DD-IG(SA)1580)

REPORTS CLOSED DURING PERIOD

For period ending _____
DoD Component _____

Audit Report Number	Report Date	Contractor Name	Type of Audit 2/	Date of Disposition 1/	Costs	
					Questioned or Cost Avoidance	Sustained/ Avoided

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* 1/ Month, day, year
2/ Use types or codes listed on Attachment 3

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	<u>Code</u>	<u>Type of Audit</u>	
	A	Estimating System Survey	
*	B	Accounting and Related Internal Control System	*
*		Reviews	*
*	C ¹	Claims	*
	D	Defective Pricing Review	
*	E	Cost Accounting Standards Noncompliance	*
		and Cost Impact Statement Reviews	
*	F ¹	Operations Audit	*
*	G ¹	Incurred Costs and Settlement of Final Indirect	*
*		Cost Rates	*
*	H ²	Contractor Insurance/Pension Reviews	*
*	I ¹	Final Pricing	*
*	J ¹	Terminations	*

*	¹ Reported costs or rates questioned and/or qualified must equal \$100,000 or more.	*
*	² Containing reported CAS noncompliances OR costs or rates questioned and/or qualified equal to \$100,000 or more.	*
*		*

3-3-1

#First Amendment (Ch 1, 8/16/95)

REPORTS SUBJECT TO TRACKING, REPORTING,
RESOLUTION, DISPOSITION AND NOTIFICATION REQUIREMENTS

A. Reports Subject to Tracking

All contract audit reports. (For preaward contract audits, including change order proposals, tracking may be accomplished using records maintained in official contract files.)

B. Reports Subject to Tracking and Reporting Requirements of Subsections F.2 and F.3., Basic Directive

1. All contract audit reports with findings and recommendations addressing:

- a. Estimating system surveys
- b. Accounting and related internal control system reviews
- c. Defective pricing reviews
- d. Cost accounting standards noncompliance reviews
- e. Cost accounting standards cost impact statement reviews

2. Reports that have findings, recommendations, and costs questioned and/or qualified of \$100,000 or more, and that address:

- a. Incurred costs
- b. Settlement of indirect cost rates
- c. Final pricing submissions
- d. Termination settlement proposals
- e. Equitable adjustment claims
- f. Hardship claims
- g. Escalation claims
- h. Operations reviews

3. All Contractor Insurance/Pension Reviews containing instances of CAS noncompliances and all Contractor Insurance/Pension Reviews with reported costs questioned of \$100,000 or more.

C. Reports Subject to Resolution

All contract audit reports