Recommendation 15: Clarify and streamline the definition of and requirements for an adequate incurred cost proposal to refocus the purpose of DoD’s oversight.

Problem
The term incurred cost proposal is not defined within federal acquisition regulations, the effect of which has been to create unnecessary burdens on both the Government and contractors. Incurred cost proposal is the government contracting community’s shorthand way of referring to a contractor’s final indirect cost rate proposal. An annual final indirect cost rate proposal, the elements of which are defined in FAR 52.216-7(d), is necessary for the contractor and the government to establish final indirect cost rates for purposes of settling provisionally billed (i.e., estimated) indirect costs on flexibly priced contracts. The government’s responsibilities for negotiating or establishing final indirect cost rates is set forth in FAR 42.705.

Although the final indirect cost rate proposal necessarily includes details regarding all contract costs (indirect and direct), direct costs are included because (a) the government needs to verify the completeness and accuracy of the contractor’s total costs to avoid double-counting and (b) direct costs are the most common means by which contractors allocate indirect costs to contracts. A final indirect cost rate proposal is not a claim for direct costs incurred and billed during contract performance. FAR 42.702 indicates that an audit of the final indirect cost rate proposal is performed for the sole purpose of negotiating final indirect cost rates.

In recent years, DCAA began auditing direct costs, as well as indirect costs, during its incurred cost audits. Before then, DCAA’s audit procedures concerning direct costs were limited to verifying their completeness such that final indirect cost rates are calculated accurately. In general, expanding the scope of incurred costs audits may increase the time it takes DCAA to complete incurred cost audits and increase the time it takes contracting officers to address and resolve the results of DCAA’s audits.

Background
The government added new requirements of an adequate final indirect cost rate proposal to FAR 52.216-7(d)(2)(iii) in 2011. These newly required elements of a final indirect cost rate proposal were directly based on DCAA’s incurred cost electronic model, which DCAA created many years ago to help contractors prepare their final indirect cost rate proposals in a consistent manner and provide appropriate cost detail to make DCAA’s audit oversight more efficient. Many of the required elements of an adequate final indirect cost rate proposal have no bearing on calculating, understanding, auditing, and negotiating final indirect cost rates. This collection of unnecessary data has contributed to DCAA losing its focus on the purpose and scope of contractors’ final indirect cost rate proposal and has created unnecessary work for contractors, DCAA, and especially contracting officers.

1 Definitions of Word and Terms, FAR Part 2. Contract Administration and Audit Services, FAR Part 42.
2 Indirect Cost Rates: Purpose, FAR 42.702.
Findings
The timeliness of final rate settlements and consequent contract closeouts will substantially improve if DCAA refocuses its oversight on the purpose of the final indirect cost rate proposal to reasonably ensure the allowability of contractors’ actual indirect costs, not direct costs. The term incurred cost proposal is not defined anywhere in the FAR, it must be made clear it is the same as—not different from—a final indirect cost rate proposal. This small change will help DCAA and contracting officers refocus on the purpose of FAR 52.216-7(d) and FAR 42.705.

Conclusions
Reviewing and settling contractor final indirect cost rates as a reform measure may raise concern among some stakeholders about DCAA’s oversight of contractor direct costs. The allowability of contractor direct costs is also an important compliance requirement. It is not, however, the purpose of DCAA’s evaluation of contractor final indirect cost rate proposal. Rather, a contracting officer may request DCAA to audit the direct costs of a contract pursuant to FAR 52.216-7(g), which is an entirely different oversight request than a final indirect cost rate proposal audit.4 If DCAA performs adequate voucher reviews, which has always been one of DCAA’s important responsibilities, there should be no cause for concern.

DCAA must refocus on its mission of providing contracting officers with the information they need to do their jobs as prescribed in contracts and by the FAR. DCAA should not be auditing direct contract costs unless requested to do so by the contracting officer as set forth in FAR 52.216-7(g).

Several final indirect cost rate proposal schedules that have no bearing on evaluating or settling final indirect cost rates should be removed. These schedules are currently required; they should be made optional information that may be required, if necessary, during the audit process. This relatively minor adjustment will meaningfully reduce contractors’ burden to prepare its final indirect cost rate proposal and help DCAA stay focused on the purpose of contractors’ proposals and contracting officers’ responsibility to settle indirect cost rates.

Implementation

Legislative Branch

- No statutory changes are required.

Executive Branch

- Define incurred cost proposal in FAR 52.216-7 as being synonymous with a final indirect cost rate proposal, and make some elements (I-M and O) of the indirect cost rate proposal in FAR 52.216-7(d)(2)(iii) optional.

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4 Allowable Cost and Payment: Audit, FAR 52.216-7(g), states: “At any time or times before final payment, the Contracting Officer may have the Contractor’s invoices or vouchers and statements of cost audited. Any payment may be: (1) reduced by amounts found by the Contracting Officer not to constitute allowable costs; or (2) Adjusted for prior overpayments or underpayments.”
Implications for Other Agencies

- Because the FAR pertains to agencies across the federal government, any changes to the FAR would affect other agencies in that they would be expected to implement the changes, as would DoD.