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DEPARTMENT OF DEFENSE

Defense Acquisition Regulations System

48 CFR Parts 215, 242, and 252

RIN 0750-AI20

Defense Federal Acquisition Regulation Supplement; Business Systems Compliance (DFARS Case 2012-D042)

AGENCY: Defense Acquisition Regulations System, Department of Defense (DoD).

ACTION: Proposed rule.

SUMMARY: DoD is proposing to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to ensure appropriate contractor accountability for adequate contractor business systems. In addition to the request for written comments on this proposed rule, DoD will hold a public meeting to hear the views of interested parties.

DATES: Comment Date: Comments on the proposed rule should be submitted in writing to the address shown below on or before **[Insert date 60 days after date of publication in the *FEDERAL REGISTER*]**, to be considered in the formation of a final rule.

Public Meeting Date: The public meeting will be held at the Mark Center Auditorium, 4800 Mark Center Drive, Alexandria, VA 22350-3603, on August 18, 2014, from 2 p.m. to 4 p.m., local time.

ADDRESSES: Submission of comments: You may submit comments, identified by DFARS Case 2012-D042, using any of the following methods:

Regulations.gov: <http://www.regulations.gov>.

Submit comments via the Federal eRulemaking portal by inserting "DFARS Case 2012-D042" under the heading "Enter keyword or ID" and selecting "Search." Select the link "Submit a Comment" that corresponds with "DFARS Case 2012-D042." Follow the instructions provided at the "Submit a Comment" screen. Please include your name, company name (if any), and "DFARS Case 2012-D042" on your attached document. Follow the instructions for submitting comments.

E-mail: osd.dfars@mail.mil. Include DFARS Case 2012-D042 in the subject line of the message.

Fax: 571-372-6094.

Mail: Defense Acquisition Regulations System, Attn: Mr. Mark Gomersall, OUSD(AT&L)DPAP(DARS), Room 3B941, 3060 Defense Pentagon, Washington, DC 20301-3060.

Comments received generally will be posted without change to <http://www.regulations.gov>, including any personal information provided. To confirm receipt of your comment(s), please check www.regulations.gov approximately two to three days after submission to verify posting (except allow 30 days for posting of comments submitted by mail).

FOR FURTHER INFORMATION CONTACT: Mr. Mark Gomersall, Defense Acquisition Regulations System, OUSD(AT&L)DPAP(DARS), Room 3B941, 3060 Defense Pentagon, Washington, DC 20301-3060. Telephone 571-372-6099.

SUPPLEMENTARY INFORMATION:

I. Background

Contractor business systems and internal controls are the first line of defense against waste, fraud, and abuse. Weak control systems increase the risk of unallowable and unreasonable costs on Government contracts. In response to a U.S. Government Accountability Office report (GAO-12-83) issued on November 3, 2011, Defense Contract Management Agency: Amid Ongoing Efforts to Rebuild Capacity, Several Factors Present Challenges in Meeting Its Mission, DoD agreed to consider alternative approaches to audit contractor business systems.

II. Discussion and Analysis

To improve the efficiency and effectiveness of auditing contractor business systems, DoD is proposing to amend the DFARS to entrust contractors with the capability to demonstrate compliance with DFARS system criteria for contractors' accounting systems, estimating systems, and material management and accounting systems, based on contractors' self-evaluations and audits by independent Certified Public Accountants (CPAs) of

their choosing. Government auditors will perform overviews of the results of contractor self-evaluations and CPA audits.

Individuals wishing to attend the public meeting should register by August 11, 2014, to ensure adequate room accommodations and to facilitate entry into the Mark Center building. Interested parties may register at the website, http://www.acq.osd.mil/dpap/dars/business_systems_compliance.htm by providing the following information:

- Company or organization name.
- Names and email addresses of persons planning to attend.
- Identify if desiring to make a presentation; limited to a 10-minute presentation per company or organization.

One valid government-issued photo identification card will be required in order to enter the building. Non-U.S. citizens may use their valid passport as photo identification. Attendees are encouraged to arrive at least one hour early to accommodate security procedures.

Transportation information for the Mark Center may be obtained at <http://www.whs.mil/our-services/transportation/getting-mark-center>. Accommodations for parking at the Mark Center will not be available, but may be found in the surrounding areas.

If you wish to make a presentation, please submit an electronic copy of your presentation to osd.dfars@mail.mil no

later than August 13, 2014. Files must not exceed 19MB. Please cite "Public Meeting—Contractor Business Systems Compliance" in all correspondence related to this public meeting. When submitting presentations, provide the presenter's name, organization affiliation, telephone number, and e-mail address on the cover page. There will be no transcription of the public meeting. Submitted presentations will be the only record.

Special accommodations: The public meeting is physically accessible to people with disabilities. Requests for reasonable accommodations, sign language interpretation or other auxiliary aids should be directed to Mark Gomersall at 571-372-6099, at least 10 working days prior to the meeting date.

The TTY number for further information is: 1-800-877-8339. When the operator answers the call, let them know the agency is the Department of Defense; the point of contact is Mark Gomersall at 571-372-6099.

III. Executive Orders 12866 and 13563

Executive Orders (E.O.s) 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). E.O. 13563 emphasizes the importance of quantifying both costs and

benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This is not a significant regulatory action and, therefore, was not subject to review under section 6(b) of E.O. 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

IV. Regulatory Flexibility Act

DoD has prepared an initial regulatory flexibility analysis consistent with 5 U.S.C. 603. A copy of the analysis may be obtained from the point of contact specified herein. The analysis is summarized as follows:

The objective of the rule is to improve the efficiency and effectiveness of auditing contractor business systems by entrusting contractors with the capability to demonstrate compliance with the Defense Federal Acquisition Regulation Supplement (DFARS) system criteria for contractors' accounting systems, estimating systems, and material management and accounting systems, based on contractors' self-evaluations and audits by independent Certified Public Accountants (CPAs) of their choosing. The requirements of the rule will apply to solicitations and contracts that include the contract clause for the applicable defined contractor business system.

The rule will apply to solicitations and contracts that are with large businesses for the purposes of reporting for

estimating systems, and material management and accounting systems. For reporting on accounting systems, the rule will apply to contractors who are subject to the Cost Accounting Standards (CAS) under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201-1 (see the FAR Appendix), other than for contracts with educational institutions, Federally Funded Research and Development Centers operated by educational institutions, or University Associated Research Centers. Since contracts and subcontracts with small businesses are exempt from CAS requirements, DoD estimates that this rule will have no impact on small businesses. DoD, however, invites comments from small business concerns and other interested parties on the expected impact of this rule on small entities.

DoD will also consider comments from small entities concerning the existing regulations in subparts affected by this rule in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 610 (DFARS Case 2012-D042) in correspondence.

V. Paperwork Reduction Act

The Paperwork Reduction Act (44 U.S.C. chapter 38) applies. The proposed rule contains information collection requirements. Accordingly, DoD has submitted a request for approval of a new information collection requirement concerning Defense Federal

Acquisition Regulation Supplement; Business Systems Compliance (DFARS Case 2012-D042) to the Office of Management and Budget.

A. Public reporting burden for this collection of information is estimated to average 2.87 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

The annual reporting burden estimated as follows:

Respondents: 2,953.

Responses per respondent: 1.

Total annual responses: 2,953.

Average hours per response: 2.87.

Total annual burden hours: 8,468.

B. Request for Comments Regarding Paperwork Burden.

Written comments and recommendations on the proposed information collection, including suggestions for reducing this burden, should be sent to Ms. Jasmeet Seehra at the Office of Management and Budget, Desk Officer for DoD, Room 10236, New Executive Office Building, Washington, DC 20503, or e-mail Jasmeet_K._Seehra@omb.eop.gov, with a copy to the Defense Acquisition Regulations System, Attn: Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B941, 3060 Defense Pentagon, Washington, DC 20301-3060. Comments can be received from 30 to 60 days after the date of this notice, but comments to OMB will

be most useful if received by OMB within 30 days after the date of this notice.

Public comments are particularly invited on: whether this collection of information is necessary for the proper performance of functions of the DFARS, and will have practical utility; whether our estimate of the public burden of this collection of information is accurate, and based on valid assumptions and methodology; ways to enhance the quality, utility, and clarity of the information to be collected; and ways in which we can minimize the burden of the collection of information on those who are to respond, through the use of appropriate technological collection techniques or other forms of information technology.

To request more information on this proposed information collection or to obtain a copy of the proposal and associated collection instruments, please write to the Defense Acquisition Regulations System, Attn: Mark Gomersall, OUSD(AT&L)DPAP/DARS, Room 3B941, 3060 Defense Pentagon, Washington, DC 20301-3060, or e-mail osd.dfars@mail.mil. Include DFARS Case 2012-D042 in the subject line of the message.

List of Subjects in 48 CFR Parts 215, 242, and 252

Government procurement.

Amy G. Williams,

Deputy, Defense Acquisition Regulations System.

Therefore, 48 CFR parts 215, 242, and 252 are proposed to be amended as follows:

1. The authority citation for parts 215, 242, and 252 continues to read as follows:

Authority: 41 U.S.C. 1303 and 48 CFR chapter 1.

PART 215—CONTRACTING BY NEGOTIATION

2. Revise section 215.407-5-70 to read as follows:

215.407-5-70 Disclosure, maintenance, and review requirements.

(a) Definitions. As used in this section—

Acceptable estimating system, contractor, contractor's certified public accountant (CPA), CPA audit, estimating system, and significant deficiency are defined in the clause at 252.215-7002, Cost Estimating System Requirements.

(b) Applicability. A contractor, other than a small business concern, is subject to the estimating system disclosure, maintenance, review, annual reporting, triennial CPA audit, and documentation requirements in the clause at 252.215-7002, Cost Estimating System Requirements, if—

(1) In its preceding fiscal year, the contractor received DoD prime contracts or subcontracts totaling \$50 million or more for which certified cost or pricing data were required; or

(2) In its preceding fiscal year, the contractor received DoD prime contracts or subcontracts totaling \$10 million or more (but

less than \$50 million) for which certified cost or pricing data were required and the contracting officer, with concurrence or at the request of the ACO, determines it to be in the best interest of the Government (e.g., significant estimating problems are believed to exist or the contractor's sales are predominantly Government).

(c) Policy. DoD policy is for all contractors to have acceptable estimating systems that consistently produce well-supported proposals that are acceptable as a basis for negotiation of fair and reasonable prices.

(d) Procedures. (1) The contracting officer shall—

(i) Through use of the clause at 252.215-7002, Cost Estimating System Requirements, apply the disclosure, maintenance, review, annual reporting, triennial CPA audit, and documentation requirements to contractors, other than small business concerns, meeting the criteria in paragraph (b)(1) of this section;

(ii) Consider whether to apply the disclosure, maintenance, review, annual reporting, triennial CPA audit, and documentation requirements to contractors, other than small business concerns, under paragraph (b)(2) of this section; and

(iii) Not apply the disclosure, maintenance, review, annual reporting, triennial CPA audit, and documentation requirements to small business concerns.

(2) The cognizant contracting officer, in consultation with the Government auditor, for contractors subject to paragraph (b) of this section, shall—

(i) Determine the acceptability of the contractor's estimating system and disclosure, and approve or disapprove the system; and

(ii) Pursue correction of any deficiencies.

(3) Triennial CPA audit requirement. For contractors subject to paragraph (b) of this section, and paragraph (d) (8) of the clause at 252.215-7002, the cognizant contracting officer shall—

(i) Upon receipt of the contractor's CPA's audit strategy, risk assessment, and audit plan (program), request a review from the Government auditor, and notify the contractor of any potential issues identified by the Government auditor regarding their reasonableness. Early notification of potential issues may decrease the likelihood of the contractor incurring unreasonable costs. However, review of the contractor's CPA's audit strategy, risk assessment, and audit plan (program) does not constitute the contracting officer's approval; and

(ii) Upon receipt of the contractor's CPA audit report, request the Government auditor's assessment of the CPA audit report and related documentation.

(4) In evaluating the acceptability of a contractor's estimating system, the contracting officer, in consultation with the Government auditor, shall determine whether the contractor's estimating system complies with the system criteria for an acceptable estimating system in the clause at 252.215-7002. In making that determination, the contracting officer shall consider-

(i) The contractor's estimating system disclosure, annual report on the estimating system's compliance with the system criteria and the audit report by the contractor's CPA, as required in the clause at 252.215-7002, if applicable; and

(ii) Any other findings and recommendations reported by the Government auditor including the assessment of the contractor's CPA audit report and related documentation, if applicable.

(e) Accelerated audit requirement. The contracting officer, in consultation with the Government auditor, may require contractors subject to the triennial CPA audit requirement in the clause at 252.215-7002 to provide an out-of-cycle CPA audit report prior to the triennial CPA audit period based on a risk assessment of the contractor's past experience and current vulnerability.

(f) Disposition of findings-(1) Reporting of findings by the Government auditor. The Government auditor shall document findings and recommendations in a report to the contracting officer regarding any identified significant estimating system deficiencies. The report shall describe the deficiencies in

sufficient detail to allow the contracting officer to understand the deficiencies.

(2) Initial determination. (i) The contracting officer shall review all findings and recommendations from the Government auditor and contractor and, if there are no significant deficiencies and the contractor has complied with the applicable reporting and audit requirements in paragraphs (d)(5) and (6) of the clause at 252.215-7002, shall promptly notify the contractor, in writing, that the contractor's estimating system is acceptable and approved; or

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.215-7002 due to the contractor's failure to meet one or more of the estimating system criteria in the clause at 252.215-7002, or that the contractor has failed to comply with the applicable reporting and audit requirements in accordance with the clause at 252.215-7002, the contracting officer shall-

(A) (1) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency; or

(2) Promptly make an initial written determination on the contractor's failure to comply with the applicable reporting and audit requirements and notify the contractor, in writing,

providing sufficient information to allow the contractor to understand what action needs to be taken to comply;

(B) Request the contractor to respond, in writing, to the initial determination within 30 days; and

(C) Promptly evaluate the contractor's responses to the initial determination, in consultation with the Government auditor or functional specialist, and make a final determination.

(3) Final determination. (i) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(A) The contractor's estimating system is acceptable and approved, and no significant deficiencies remain, and the contractor has complied with the applicable reporting and audit requirements in accordance with the clause at 252.215-7002; or

(B) Significant deficiencies remain, or the contractor has failed to comply with the applicable reporting and audit requirements. The notice shall identify any remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements, and indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones

and actions to eliminate the deficiencies and comply with the applicable reporting and audit requirements;

(2) Disapprove the system in accordance with the clause at 252.215-7002; and

(3) Withhold payments in accordance with the clause at 252.242-7005 if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 215.407-5-70(f).

(g) System approval. The contracting officer shall promptly approve a previously disapproved estimating system and notify the contractor when the contracting officer determines that there are no remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements.

(h) Contracting officer notifications. The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, to disapprove a system and withhold payments, or to approve a previously disapproved system and release withheld payments to the Government auditor, payment office, affected contracting officers at the buying activities, and cognizant contracting officers in contract administration activities.

PART 242—CONTRACT ADMINISTRATION AND AUDIT SERVICES

242.7000 and 242.7001 [Redesignated as 242.7001 and 242.7003]

3. Redesignate sections 242.7000 and 242.7001 as sections 242.7001 and 242.7003, respectively.

4. Revise newly redesignated section 242.7001 to read as follows:

242.7001 Definitions.

As used in this subpart—

Acceptable contractor business systems, contractor business systems, contractor's certified public accountant (CPA), and CPA audit are defined in the clause at 252.242-7005, Contractor Business Systems.

Covered contract means a contract that is subject to the Cost Accounting Standards under 41 U.S.C. chapter 15, as implemented in regulations found at 48 CFR 9903.201-1 (see the FAR Appendix) (10 U.S.C. 2302 note, as amended by section 816 of Public Law 112-81).

Significant deficiency is defined in the clause at 252.242-7005, Contractor Business Systems.

5. Add section 242.7002 to read as follows:

242.7002 Contractor business systems deficiencies.

(a) Determination to withhold payments. If the contracting officer makes a final determination to disapprove a contractor's business system in accordance with the clause at 252.242-7005, Contractor Business Systems, the contracting officer shall—

(1) In accordance with agency procedures, identify one or more covered contracts containing the clause at 252.242-7005 from which payments will be withheld. When identifying the covered

contracts from which to withhold payments, the contracting officer shall ensure that the total amount of payment withholding under 252.242-7005 does not exceed 10 percent of progress payments, performance-based payments, and interim payments under cost-reimbursement, labor-hour, and time-and-materials contracts billed under each of the identified covered contracts. Similarly, the contracting officer shall ensure that the total amount of payment withholding under the clause at 252.242-7005 for each business system does not exceed five percent of progress payments, performance-based payments, and interim payments under cost-reimbursement, labor-hour, and time-and-materials contracts billed under each of the identified covered contracts. The contracting officer has the sole discretion to identify the covered contracts from which to withhold payments;

(2) Promptly notify the contractor, in writing, of the contracting officer's determination to implement payment withholding in accordance with the clause at 252.242-7005. The notice of payment withholding shall be included in the contracting officer's written final determination for the contractor business system and shall inform the contractor that—

(i) Payments shall be withheld from the contract or contracts identified in the written determination in accordance with the clause at 252.242-7005 until the contracting officer determines that there are no remaining significant deficiencies and

that the contractor has complied with the applicable reporting and audit requirements in accordance with the applicable business system clause identified in 242.7003(b); and

(ii) The contracting officer reserves the right to take other actions within the terms and conditions of the contract; and

(3) Provide all contracting officers administering the selected contracts from which payments will be withheld, a copy of the determination. The contracting officer shall also provide a copy of the determination to the Government auditor; payment office; affected contracting officers at the buying activities; and cognizant contracting officers in contract administration activities.

(b) Monitoring contractor's corrective action. The contracting officer, in consultation with the Government auditor or functional specialist, shall monitor the contractor's progress in correcting the deficiencies. The contracting officer shall notify the contractor of any decision to decrease or increase the amount of payment withholding in accordance with the clause at 252.242-7005.

(c) Correction of significant deficiencies and reporting.

(1) If the contractor notifies the contracting officer that the contractor has corrected the significant deficiencies and, if applicable, provides the contractor's CPA audit report on the effectiveness of the corrective actions, the contracting officer shall review the correction to verify that the

deficiencies have been corrected. If the contracting officer determines that the contractor has corrected all significant deficiencies and provided the contractor's report on compliance with the system criteria, including the CPA audit report, if applicable, the contracting officer shall discontinue the withholding of payments, release any payments previously withheld, and approve the system, unless other significant deficiencies remain.

(2) Prior to the determination that the deficiencies have been corrected, the contracting officer may discontinue withholding payments pending the determination, and release any payments previously withheld, if the contractor submits evidence that the significant deficiencies have been corrected, and the contracting officer, in consultation with the Government auditor or functional specialist, determines that there is a reasonable expectation that the corrective actions have been implemented and are expected to correct the significant deficiencies.

(3) Within 90 days of receipt of the contractor notification that the contractor has corrected the significant deficiencies and, if applicable, the contractor's CPA audit report on the effectiveness of the corrective actions, the contracting officer shall—

(i) Make a determination that—

(A) The contractor has corrected all significant

deficiencies as directed by the contracting officer's final determination in accordance with paragraph (c) (1) of this section;

(B) There is a reasonable expectation that the corrective actions have been implemented in accordance with paragraph (c) (2) of this section; or

(C) The contractor has not corrected all significant deficiencies as directed by the contracting officer's final determination in accordance with paragraph (c) (1) of this section, or there is not a reasonable expectation that the corrective actions have been implemented in accordance with paragraph (c) (2) of this section; and

(ii) Reduce withholding directly related to the significant deficiencies covered under the corrective action plan by at least 50 percent of the amount being withheld from progress payments and performance-based payments, and direct the contractor, in writing, to reduce the percentage withheld on interim cost vouchers by at least 50 percent, until the contracting officer makes a determination in accordance with paragraph (c) (3) (i) of this section.

(4) If, at any time, the contracting officer determines that the contractor has failed to correct the significant deficiencies identified in the contractor's notification, the contracting officer will continue, reinstate, or increase withholding from progress payments and performance-based payments, and direct the

contractor, in writing, to continue, reinstate, or increase the percentage withheld on interim cost vouchers to the percentage initially withheld, until the contracting officer determines that the contractor has corrected all significant deficiencies as directed by the contracting officer's final determination.

(d) For sample formats for written notifications of contracting officer determinations to initiate payment withholding, reduce payment withholding, and discontinue payment withholding in accordance with the clause at 252.242-7005. See PGI 242.7002.

6. In newly redesignated section 242.7003, revise paragraph (a) to read as follows:

242.7003 Contract clause.

* * * * *

(a) The resulting contract will be a covered contract as defined in 242.7001; and

* * * * *

7. Revise sections 242.7201, 242.7202, and 242.7203 to read as follows:

242.7201 Definitions.

As used in this subpart—

Acceptable material management and accounting system,
contractor, contractor's certified public accountant (CPA), CPA
audit, material management and accounting system, qualifying sales,
significant deficiency, and valid time-phased requirements are

defined in the clause at 252.242-7004, Material Management and Accounting System.

242.7202 Policy.

(a) DoD policy is for its contractors to have an MMAS that conforms to the standards in paragraph (h) of the clause at 252.242-7004, Material Management and Accounting System, so that the system—

(1) Reasonably forecasts material requirements;

(2) Ensures the costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements; and

(3) Maintains a consistent, equitable, and unbiased logic for costing of material transactions.

(b) Criteria for conducting reviews. Conduct an MMAS review in accordance with paragraph (d) of the clause at 252.242.7004, when—

(1) The contractor is a large business;

(2) Has \$50 million in qualifying sales to the Government; and

(3) The cognizant contracting officer, with advice from the Government auditor or cognizant functional specialist, determines an MMAS review is needed based on a risk assessment of the contractor's past experience, current vulnerability, and the following risk factors:

(i) FAR 42.302 surveillance activities indicate the contractor has not complied with the criteria in 252.242.7004.

(ii) There are changes to the contractor's MMAS system.

(iii) The contractor's MMAS system is new.

(iv) The contractor's MMAS system has not been reviewed within a 36-month period.

(c) Contractors subject to the triennial CPA audit requirement in the clause at 252.242-7004, may be required to provide an out-of-cycle CPA audit report prior to the triennial CPA audit reporting period based on a risk assessment of the contractor's past experience and current vulnerability.

(d) The cognizant contracting officer, in consultation with the Government auditor and cognizant functional specialist, if appropriate, shall—

(1) Determine the acceptability of the contractor's MMAS and approve or disapprove the system; and

(2) Pursue correction of any deficiencies.

242.7203 Procedures.

(a) Triennial CPA audit requirement. For contractors subject to paragraph (f) of the clause at 252.242-7004, Material Management and Accounting System, the cognizant contracting officer shall—

(1) Upon receipt of the contractor's CPA's audit strategy, risk assessment, and audit plan (program), request a review from the Government auditor, and notify the contractor of any potential

issues identified by the Government auditor regarding their reasonableness. Early notification of potential issues may decrease the likelihood of the contractor incurring unreasonable costs. However, review of the contractor's CPA's audit strategy, risk assessment, and audit plan (program) does not constitute the contracting officer's approval; and

(2) Upon receipt of the contractor's CPA audit report, request the Government auditor's assessment of the CPA audit report and related documentation.

(b) In evaluating the acceptability of the contractor's MMAS, the contracting officer, in consultation with the Government auditor and functional specialist, if appropriate, shall determine whether the contractor's MMAS complies with the system criteria for an acceptable MMAS as required in the clause at 252.242-7004. In making that determination, the contracting officer shall consider—

(1) The contractor's report on the MMAS's compliance with the system criteria and the audit report by the contractor's CPA, as required in the clause at 252.242-7004; and

(2) Any other findings and recommendations reported by the Government auditor including the assessment of the contractor's CPA audit report and related documentation, if applicable.

(c) Disposition of findings—(1) Reporting of findings by the Government auditor. The Government auditor or functional specialist shall document findings and recommendations in a report

to the contracting officer regarding any identified significant MMAS deficiencies. The report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies.

(2) Initial determination. (i) The contracting officer shall review all findings and recommendations from the Government auditor and contractor and, if there are no significant deficiencies and the contractor has complied with the applicable reporting and audit requirements in paragraph (d) of the clause at 252.242-7004, shall promptly notify the contractor, in writing, that the contractor's MMAS is acceptable and approved.

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.242-7004 due to the contractor's failure to meet one or more of the MMAS system criteria in the clause at 252.242-7004, or that the contractor has failed to comply with the applicable reporting and audit requirements in accordance with the clause at 252.242-7004, the contracting officer shall—

(A) (1) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency; or

(2) Promptly make an initial written determination on the contractor's failure to comply with the applicable reporting and audit requirements and notify the contractor, in writing, providing sufficient information to allow the contractor to understand what action needs to be taken to comply;

(B) Request the contractor to respond, in writing, to the initial determination within 30 days; and

(C) Promptly evaluate the contractor's response to the initial determination in consultation with the Government auditor or functional specialist, and make a final determination.

(3) Final determination. (i) The contracting officer shall make a final determination and notify the contractor that—

(A) The contractor's MMAS is acceptable and approved, and no deficiencies remain, and the contractor has complied with the applicable reporting and audit requirements in accordance with the clause at 252.242-7004; or

(B) Significant deficiencies remain, or the contractor has failed to comply with the applicable reporting and audit requirements. The notice shall identify any remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements and indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies

or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies and comply with the applicable reporting and audit requirements;

(2) Disapprove the system in accordance with the clause at 252.242-7004; and

(3) Withhold payments in accordance with the clause at 252.242-7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 242.7203.

(d) System approval. The contracting officer shall promptly approve a previously disapproved MMAS and notify the contractor when the contracting officer determines that there are no remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements.

(e) Contracting officer notifications. The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, to disapprove a system and withhold payments, or to approve a previously disapproved system and release withheld payments to the Government auditor, payment office, affected contracting officers at the buying activities, and cognizant contracting officers in contract administration activities.

8. Revise sections 242.7501 and 242.7502 to read as follows:

242.7501 Definitions.

As used in this subpart—

Acceptable accounting system, accounting system, contractor's certified public account (CPA), CPA audit, and significant deficiency are defined in the clause at 252.242-7006, Accounting System Administration.

242.7502 Policy.

DoD policy is for contractors receiving cost-reimbursement, incentive type, time-and-materials, or labor-hour contracts, or contracts which provide for progress payments based on costs or on a percentage or stage of completion, to—

(a) Maintain an acceptable accounting system; and

(b) If applicable, comply with the annual reporting, triennial CPA audit, and documentation requirements required in the clause at 252.242-7006, Accounting System Administration.

242.7503 [Redesignated as 242.7504]

9. Redesignate section 242.7503 as section 242.7504.

10. Add a new section 242.7503 to read as follows:

242.7503 Procedures.

(a) The cognizant contracting officer, in consultation with the Government auditor or functional specialist, shall—

(1) Determine the acceptability of a contractor's accounting system and approve or disapprove the system; and

(2) Pursue correction of any deficiencies.

(b) Triennial CPA audit requirement. For contractors subject to paragraph (h) of the clause at 252.242-7006, the cognizant contracting officer shall—

(1) Upon receipt of the contractor's CPA's audit strategy, risk assessment, and audit plan (program), request a review from the Government auditor and notify the contractor of any potential issues identified by the Government auditor regarding their reasonableness. Early notification of potential issues may decrease the likelihood of the contractor incurring unreasonable costs. However, review of the contractor's CPA's audit strategy, risk assessment, and audit plan (program) does not constitute the contracting officer's approval; and

(2) Upon receipt of the contractor's CPA audit report, request the Government auditor's assessment of the CPA audit report and related documentation.

(c) In evaluating the acceptability of a contractor's accounting system, the contracting officer, in consultation with the Government auditor or functional specialist, shall determine whether the contractor's accounting system complies with the system criteria for an acceptable accounting system in the clause at 252.242-7006. In making that determination the contracting officer shall consider—

(1) The contractor's annual report on the accounting system's compliance with the system criteria and the audit report by the contractor's CPA as required in the clause at 252.242-7006, if applicable; and

(2) Any other findings and recommendations reported by the Government auditor including the assessment of the contractor's CPA audit report and related documentation, if applicable.

(d) Accelerated audit requirement. The contracting officer, in consultation with the Government auditor, may require contractors subject to the triennial CPA audit requirement in the clause at 252.242-7006 to provide an out-of-cycle CPA audit report prior to the triennial CPA audit period based on a risk assessment of the contractor's past experience and current vulnerability.

(e) Disposition of findings-(1) Reporting of findings by the Government auditor. The Government auditor shall document findings and recommendations in a report to the contracting officer regarding any identified significant accounting system deficiencies. The report shall describe the deficiencies in sufficient detail to allow the contracting officer to understand the deficiencies. Follow the procedures at PGI 242.7503 for reporting of deficiencies.

(2) Initial determination. (i) The contracting officer shall review all findings and recommendations from the Government auditor and contractor and, if there are no significant

deficiencies and the contractor has complied with the applicable reporting and audit requirements in paragraphs (e) and (f) of the clause at 252.242-7006, shall promptly notify the contractor, in writing, that the accounting system is acceptable and approved.

(ii) If the contracting officer finds that there are one or more significant deficiencies (as defined in the clause at 252.242-7006 due to the contractor's failure to meet one or more of the estimating system criteria in the clause at 252.242-7006, or that the contractor has failed to comply with the applicable reporting and audit requirements in accordance with the clause at 252.242-7006, the contracting officer shall—

(A) (1) Promptly make an initial written determination on any significant deficiencies and notify the contractor, in writing, providing a description of each significant deficiency in sufficient detail to allow the contractor to understand the deficiency; or

(2) Promptly make an initial written determination on the contractor's failure to comply with the applicable reporting and audit requirements and notify the contractor, in writing, providing sufficient information to allow the contractor to understand what action needs to be taken to comply;

(B) Request the contractor to respond, in writing, to the initial determination within 30 days; and

(C) Promptly evaluate the contractor's response to the initial determination, in consultation with the Government auditor or functional specialist, and make a final determination.

(3) Final determination. (i) The contracting officer shall make a final determination and notify the contractor, in writing, that—

(A) The contractor's accounting system is acceptable and approved, and no significant deficiencies remain, and the contractor has complied with the applicable reporting and audit requirements in accordance with the clause at 252.242-7006, or

(B) Significant deficiencies remain, or the contractor has failed to comply with the applicable reporting and audit requirements. The notice shall identify any remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements, and indicate the adequacy of any proposed or completed corrective action. The contracting officer shall—

(1) Request that the contractor, within 45 days of receipt of the final determination, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies and comply with the applicable reporting and audit requirements;

(2) Disapprove the system in accordance with the clause at 252.242-7006; and

(3) Withhold payments in accordance with the clause at 252.242-7005, Contractor Business Systems, if the clause is included in the contract.

(ii) Follow the procedures relating to monitoring a contractor's corrective action and the correction of significant deficiencies in PGI 242.7503.

(f) System approval. The contracting officer shall promptly approve a previously disapproved accounting system and notify the contractor when the contracting officer determines that there are no remaining significant deficiencies or noncompliance with the applicable reporting and audit requirements.

(g) Contracting officer notifications. The cognizant contracting officer shall promptly distribute copies of a determination to approve a system, to disapprove a system and withhold payments, or to approve a previously disapproved system and release withheld payments to the Government auditor, payment office, affected contracting officers at the buying activities, and cognizant contracting officers in contract administration activities.

(h) Mitigating the risk of accounting system deficiencies on specific proposals. (1) Field pricing teams shall discuss identified accounting system deficiencies and their impact in all reports on contractor proposals until the deficiencies are resolved.

(2) The contracting officer responsible for negotiation of a proposal generated by an accounting system with an identified deficiency shall evaluate whether the deficiency impacts the negotiations. If it does not, the contracting officer should proceed with negotiations. If it does, the contracting officer should consider other alternatives, for example—

(i) Allowing the contractor additional time to correct the accounting system deficiency and submit a corrected proposal;

(ii) Considering another type of contract;

(iii) Using additional cost analysis techniques to determine the reasonableness of the cost elements affected by the accounting system's deficiency;

(iv) Reducing the negotiation objective for profit or fee; or

(v) Including a contract (reopener) clause that provides for adjustment of the contract amount after award.

(3) The contracting officer who incorporates a reopener clause into the contract is responsible for negotiating price adjustments required by the clause. Any reopener clause necessitated by an accounting system deficiency should—

(i) Clearly identify the amounts and items that are in question at the time of negotiation;

(ii) Indicate a specific time or subsequent event by which the contractor will submit a supplemental proposal, including

certified cost or pricing data, identifying the cost impact adjustment necessitated by the deficient accounting system;

(iii) Provide for the contracting officer to adjust the contract price unilaterally if the contractor fails to submit the supplemental proposal; and

(iv) Provide that failure of the Government and the contractor to agree to the price adjustment shall be a dispute under the Disputes clause.

242.7504 [Amended]

11. In newly redesignated section 242.7504, remove the bracket at the end of paragraph (b).

PART 252—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

12. Amend section 252.215-7002 by—

a. Removing the clause date "(DEC 2012)" and adding in its place "(DATE)";

b. Revising paragraphs (a) and (b);

c. Amending paragraph (c) introductory text by removing "a large business" and adding "other than a small business concern" in its place;

d. Revising paragraph (d) heading and adding paragraphs (d) (5) through (9);

e. Revising paragraphs (e) and (f); and

f. Amending paragraph (g) by removing "252.242-7005," and adding "DFARS 252.242-7005," in its place.

The revisions read as follows:

252.215-7002 Cost Estimating System Requirements.

* * * * *

(a) Definitions. As used in this clause—

Acceptable estimating system means an estimating system that complies with the system criteria in paragraph (d) of this clause, and provides for a system that—

(i) Is maintained, reliable, and consistently applied;

(ii) Produces verifiable, supportable, documented, and timely cost estimates that are an acceptable basis for negotiation of fair and reasonable prices;

(iii) Is consistent with and integrated with the Contractor's related management systems; and

(iv) Is subject to applicable financial control systems.

Contractor means a business unit as defined in FAR 2.101.

Contractor's Certified Public Accountant (CPA) means an independent certified public accountant, in public practice and not directly employed as an employee by the Contractor, performing audits for the Contractor in accordance with U.S. generally accepted government auditing standards (GAGAS) as issued by the Government Accountability Office.

CPA audit means an examination of the Contractor's compliance with the applicable system criteria in paragraph (d)(4) of this

clause performed by the Contractor's CPA in accordance with GAGAS for examination attestation engagements.

Estimating system means the Contractor's policies, procedures, and practices for budgeting and planning controls, and generating estimates of costs and other data included in proposals submitted to customers in the expectation of receiving contract awards.

Estimating system includes the Contractor's—

- (i) Organizational structure;
- (ii) Established lines of authority, duties, and responsibilities;
- (iii) Internal controls and managerial reviews;
- (iv) Flow of work, coordination, and communication; and
- (v) Budgeting, planning, estimating methods, techniques, accumulation of historical costs, and other analyses used to generate cost estimates.

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

(b) General. The Contractor shall—

- (1) Establish, maintain, and comply with an acceptable estimating system; and
- (2) Make available to the Government, upon request, the results of internal or external reviews or monitoring that have

been conducted to ensure compliance with the system criteria in (d) (4) of this clause and established estimating policies and procedures.

* * * * *

(d) System and reporting requirements. * * *

(5) Annual reporting requirements. (i) The Contractor shall provide to the Contracting Officer and Government auditor within the 6-month period following the expiration of the Contractor's fiscal year, and annually thereafter, a report regarding compliance with the system criteria in paragraph (d) (4) of this clause as of the end of the Contractor's most recent fiscal year. The Contractor shall have the report signed by an individual of the Contractor's organization at a level no lower than a vice president or chief financial officer of the reporting business segment.

(ii) The report shall include—

(A) A statement that the Contractor has evaluated the estimating system's compliance with the system criteria in paragraph (d) (4) of this clause;

(B) The Contractor's assessment of the estimating system's compliance with the system criteria in paragraph (d) (4) of this clause, including a statement as to whether or not the system complies in all material respects, and disclosure of any significant deficiencies with sufficient information for the Government to understand the deficiencies; and

(C) The status of any significant deficiencies disclosed as part of the Contractor's assessment or, if applicable, in the Contractor's CPA audit report as required in paragraph (d)(6) of this clause, including a corrective action plan with milestones and actions to eliminate any significant deficiencies that have not been corrected as of the date of the Contractor's report.

(6) Triennial CPA audit requirement. (i) In the first year in which the Contractor is required to provide the annual report as required in paragraph (d)(5) of this clause, and every three years thereafter, or more frequently if directed by the Contracting Officer, in addition to the items in paragraph (d)(5)(ii) of this clause, the Contractor's annual report shall include an audit report on the Contractor's CPA's examination of the Contractor's compliance with the system criteria in paragraph (d)(4) of this clause as of the end of the most recent fiscal year.

(ii) The examination shall be performed in accordance with GAGAS for examination attestation engagements, and the CPA audit report shall include sufficient information regarding any reported significant deficiencies for the Government to understand the deficiencies.

(7) CPA selection. If paragraph (d)(6) of this clause is applicable, the Contractor shall reasonably ensure that the CPA firm performing the audit is-

(i) Independent and objective with respect to the audited entity by obtaining and reviewing a written representation from the firm that the firm (and the assigned engagement team)–

(A) Is independent and objective with respect to the audited entity;

(B) Will remain independent throughout the audit;

(C) Has not performed any nonaudit services for the audited entity that impair the auditors' independence for the subject audit; and

(D) Will disclose any independence issues discovered; and

(ii) Qualified to perform the audit by obtaining and reviewing–

(A) Information about key engagement team members regarding professional qualifications and experience, including valid CPA licenses or certificates in good standing, and current knowledge and experience in the type of work to be done; and

(B) The firm's most recent peer review report, in accordance with the American Institute of Certified Public Accountants (AICPA) Peer Review Program, or equivalent.

(8) Contractor submission of audit plan. The Contractor shall provide the Contractor's CPA's audit strategy, risk assessment, and audit plan (program), upon completion, for the audits required in paragraphs (d)(6) and (f)(2) of this clause, to

the cognizant contracting officer and Government auditor for review if-

(i) The Contractor has received Department of Defense (DoD) prime contracts or subcontracts, totaling \$100 million or more for which certified cost or pricing data were required during the fiscal year to which the Contractor's CPA audit report applies; or

(ii) Requested by the Contracting Officer, in consultation with the Government auditor.

(9) Documentation requirements. (i) If paragraphs (d) (5) and (6) of this clause are applicable, the Contractor shall maintain and make available to the Government upon request-

(A) Documentation to provide reasonable support for the assessment of the estimating system as required in paragraphs (d) (5) (ii) (B) of this clause; and

(B) Information considered in the selection of a CPA as required in paragraph (d) (7) of this clause, if applicable.

(ii) The Contractor shall arrange for Government access to the working papers supporting the CPA audit reports required in paragraphs (d) (6) and (f) (2) of this clause, and documentation supporting the Contractor's CPA's independence, objectivity and qualifications.

(e) Significant deficiencies or failure to comply with applicable reporting and audit requirements. (1) The Contracting

Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraphs (d)(5) and (6) of this clause. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and provide sufficient information on the noncompliance with the applicable reporting and audit requirements to allow the Contractor to understand what action needs to be taken to comply.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant deficiencies in the Contractor's estimating system or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraphs (d)(5) and (6) of this clause. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining significant deficiencies;
- (ii) Remaining noncompliance with the applicable reporting and audit requirements;
- (iii) The adequacy of any proposed or completed corrective action; and

(iv) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain or the Contractor has failed to comply with the applicable reporting and audit requirements.

(f) If the Contractor receives the Contracting Officer's final determination of significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in accordance with paragraphs (d)(5) and (6) of this clause, the Contractor shall—

(1) Within 45 days of receipt of the final determination, either correct the significant deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the significant deficiencies, and comply with the applicable reporting and audit requirements; and

(2) If the significant deficiencies were reported in the Contractor's annual report, or the Contractor's CPA audit report, provide the Contractor's CPA's opinion regarding the effectiveness of the corrective actions—

(i) As a part of the triennial CPA audit report as required in paragraph (d)(6) of this clause; or

(ii) In a separate audit report on the Contractor's CPA's examination of the effectiveness of the corrective action performed in accordance with GAGAS for examination attestation engagements.

* * * * *

13. Amend section 252.242-7004 by—

- a. Removing the clause date "(MAY 2011)" and adding in its place "(DATE)";
- b. Revising paragraph (a);
- c. Amending paragraph (b) (2) by removing "paragraph (e)" and adding "paragraph (h)" in its place;
- d. Revising paragraph (c) (2);
- e. Redesignating paragraphs (d) through (g) as paragraphs (h) through (k), respectively, and adding new paragraphs (d) through (g); and
- f. Revising the newly redesignated paragraphs (i) and (j).

The revisions and additions read as follows:

252.242-7004 Material Management and Accounting System.

* * * * *

(a) Definitions. As used in this clause—

Acceptable material management and accounting system means a MMAS that generally complies with the applicable system criteria in paragraph (h) of this clause.

Contractor means a business unit as defined in FAR 2.101.

Contractor's Certified Public Accountant (CPA) means an independent certified public accountant, in public practice and not directly employed as an employee by the Contractor, performing audits for the Contractor in accordance with U.S. generally

accepted government auditing standards (GAGAS), as issued by the Government Accountability Office.

CPA audit means an examination of the Contractor's compliance with the applicable system criteria in paragraph (h) of this clause performed by the Contractor's CPA in accordance with GAGAS for examination attestation engagements.

Material management and accounting system (MMAS) means the Contractor's system or systems for planning, controlling, and accounting for the acquisition, use, issuing, and disposition of material. Material management and accounting systems may be manual or automated. They may be stand-alone systems or they may be integrated with planning, engineering, estimating, purchasing, inventory, accounting, or other systems.

Qualifying sales means sales for which cost or pricing data were required under 10 U.S.C. 2306a, as implemented in FAR 15.403, or that are contracts priced on other than a firm-fixed-price or fixed-price with economic price adjustment basis. Sales include prime contracts, subcontracts, and modifications to such contracts and subcontracts.

Significant deficiency means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes.

Valid time-phased requirements means material that is-

(i) Needed to fulfill the production plan, including reasonable quantities for scrap, shrinkage, yield, etc.; and

(ii) Charged/billed to contracts or other cost objectives in a manner consistent with the need to fulfill the production plan.

* * * * *

(c) * * *

(2) Provide to the Administrative Contracting Officer (ACO), upon request, the results of internal or external reviews or monitoring that have been conducted to ensure compliance with the system criteria in paragraph (h) of this clause and established MMAS policies, procedures, and operating instructions; and

* * * * *

(d) Triennial CPA reporting and audit requirements. (1) If the Contractor is other than small business concern, has \$50 million of qualifying sales to the Government during the preceding fiscal year, and the Contracting Officer requests an MMAS review, the Contractor shall—

(i) Provide to the Contracting Officer and Government auditor within the 6-month period following the expiration of the Contractor's fiscal year, a report regarding the Contractor's compliance with the system criteria in paragraph (h) of this clause as of the end of the Contractor's most recent fiscal year; and

(ii) Have the report signed by an individual of the Contractor's organization at a level no lower than a vice president or chief financial officer of the reporting business segment.

(2) The report shall include—

(i) A statement that the Contractor has evaluated the MMAS's compliance with the system criteria in paragraph (h) of this clause;

(ii) The Contractor's assessment of the MMAS's compliance with the system criteria in paragraph (h) of this clause, including a statement as to whether or not the system complies in all material respects and disclosure of any significant deficiencies with sufficient information for the Government to understand the deficiencies;

(iii) An audit report on the Contractor's CPA's examination of the Contractor's compliance with the system criteria in paragraph (h) of this clause as of the end of the most recent fiscal year. The examination shall be performed in accordance with GAGAS for examination attestation engagements. The CPA audit report shall include sufficient information regarding any reported significant deficiencies for the Government to understand the deficiencies; and

(iv) The status of any significant deficiencies disclosed as part of the Contractor's assessment or in the Contractor's CPA audit report, including a corrective action plan with milestones

and actions to eliminate any significant deficiencies that have not been corrected as of the date of the Contractor's report.

(e) CPA selection. If paragraph (d) of this clause is applicable, the Contractor shall reasonably ensure that the CPA firm performing the audit is—

(1) Independent and objective with respect to the audited entity by obtaining and reviewing a written representation from the firm that the firm (and the assigned engagement team)—

(i) Is independent and objective with respect to the audited entity;

(ii) Will remain independent throughout the audit;

(iii) Has not performed any nonaudit services for the audited entity that impair the auditors' independence for the subject audit; and

(iv) Will disclose any independence issues discovered;

and

(2) Qualified to perform the audit by obtaining and reviewing—

(i) Information about key engagement team members regarding professional qualifications and experience, including valid CPA licenses or certificates in good standing, and current knowledge and experience in the type of work to be done; and

(ii) The firm's most recent peer review report, in accordance with the American Institute of Certified Public Accountants (AICPA) Peer Review Program, or equivalent.

(f) Contractor submission of audit plan. The Contractor shall provide the Contractor's CPA's audit strategy, risk assessment, and audit plan (program), upon completion, for the audits required in paragraphs (d)(2)(iii) and (j)(2) of this clause, to the cognizant contracting officer and Government auditor for review if—

(1) The Contractor has more than \$100 million in qualifying sales to the Government during the fiscal year to which the Contractor's CPA audit report applies; or

(2) Requested by the Contracting Officer, in consultation with the Government auditor.

(g) Documentation requirements. (1) If paragraph (d) of this clause is applicable, the Contractor shall maintain and make available to the Government upon request—

(i) Documentation to provide reasonable support for the assessment of the MMAS as required in paragraph (d)(2)(ii) of this clause; and

(ii) Information considered in the selection of a CPA as required in paragraph (e) of this clause.

(2) The Contractor shall arrange for Government access to the working papers supporting the CPA audit reports as required in

paragraphs (d) (2) (iii) and (j) (2) of this clause, and documentation supporting the CPA's independence, objectivity, and qualifications.

* * * * *

(i) Significant deficiencies or failure to comply with applicable reporting and audit requirements. (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraph (d) of this clause. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and provide sufficient information on the noncompliance with the applicable reporting and audit requirements to allow the Contractor to understand what action needs to be taken to comply.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant deficiencies in the Contractor's MMAS or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraph (d) of this clause. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning-

- (i) Remaining significant deficiencies;
- (ii) Remaining noncompliance with the applicable reporting and audit requirements;
- (iii) The adequacy of any proposed or completed corrective action; and
- (iv) System disapproval if the Contracting Officer determines that one or more significant deficiencies remain or the Contractor has failed to comply with the applicable reporting and audit requirements.

(j) If the Contractor receives the Contracting Officer's final determination of significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in accordance with paragraph (d) of this clause, the Contractor shall—

(1) Within 45 days of receipt of the final determination, either correct the significant deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the significant deficiencies, and comply with the applicable reporting and audit requirements; and

(2) If the significant deficiencies were reported in the Contractor's annual report, or the Contractor's CPA audit report as required in paragraph (d) of this clause, provide the Contractor's CPA's opinion regarding the effectiveness of the corrective actions—

(i) As a part of the triennial CPA audit report required in paragraph (d) of this clause; or

(ii) In a separate audit report on the Contractor's CPA's examination of the effectiveness of the corrective action performed in accordance with GAGAS for examination attestation engagements.

* * * * *

14. Amend section 252.242-7005 by—

a. In the introductory text, removing "242.7001" and adding "242.7003" in its place;

b. Removing the clause date "(FEB 2012)" and adding in its place "(DATE)";

c. Amending paragraph (b) by—

i. Revising the definition of "Contractor business systems"; and

ii. Adding, in alphabetical order, definitions for "Contractor's Certified Public Account (CPA)" and "CPA audit".

d. Revising paragraph (d);

e. Revising paragraphs (e) (1) and (2);

f. Revising paragraphs (f) (1), (f) (2) introductory text, and (f) (2) (i);

g. Amending paragraph (f) (iv) by removing "Contractor has corrected the significant deficiencies" and adding "Contractor has corrected the significant deficiencies and, if applicable, the Contractor's CPA audit report on the effectiveness of the corrective actions" in its place; and

h. Adding paragraph (g)

The additions and revisions read as follows:

252.242-7005 Contractor Business Systems.

* * * * *

(b) * * *

Contractor business systems means—

(i) Accounting system, if this contract includes the clause at DFARS 252.242-7006, Accounting System Administration;

(ii) Earned value management system, if this contract includes the clause at DFARS 252.234-7002, Earned Value Management System;

(iii) Estimating system, if this contract includes the clause at DFARS 252.215-7002, Cost Estimating System Requirements;

(iv) Material management and accounting system, if this contract includes the clause at DFARS 252.242-7004, Material Management and Accounting System;

(v) Property management system, if this contract includes the clause at DFARS 252.245-7003, Contractor Property Management System Administration; and

(vi) Purchasing system, if this contract includes the clause at DFARS 252.244-7001, Contractor Purchasing System Administration.

Contractor's Certified Public Accountant (CPA) means an independent certified public accountant, in public practice and not directly employed as an employee by the Contractor, performing

audits for the Contractor in accordance with U.S. generally accepted government auditing standards (GAGAS) as issued by the Government Accountability Office.

CPA audit means an examination of the Contractor's compliance with the applicable system criteria in the applicable business system clause in DFARS 242.7003(b) performed by the Contractor's CPA in accordance with GAGAS for examination attestation engagements.

* * * * *

(d) Significant deficiencies or failure to comply with reporting and audit requirements. (1) The Contractor shall respond, in writing, within 30 days to an initial determination of—

(i) One or more significant deficiencies in one or more of the Contractor's business systems; or

(ii) Failure to comply with the applicable reporting and audit requirements in the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of this clause.

(2) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the final determination as to whether—

(i) The Contractor's business system contains significant deficiencies; or

(ii) The Contractor has failed to comply with the applicable reporting and audit requirements in the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of this clause.

(3) If the Contracting Officer determines that the Contractor's business system contains significant deficiencies or that the contractor has failed to comply with the applicable reporting and audit requirements, the final determination will include a notice to withhold payments.

(e) Withholding payments. (1) If the Contracting Officer issues the final determination with a notice to withhold payments for significant deficiencies in a contractor business system, or for the Contractor's failure to comply with the applicable reporting and audit requirements in the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of this clause required under this contract, the Contracting Officer will withhold five percent of amounts due from progress payments and performance-based payments, and direct the Contractor, in writing, to withhold five percent from its billings on interim cost vouchers on cost-reimbursement, labor-hour, and time-and-materials contracts until the Contracting Officer has determined that the Contractor has corrected all significant deficiencies and complied with the applicable reporting and audit

requirements as directed by the Contracting Officer's final determination.

(2) If the final determination with a notice to withhold payments is for significant deficiencies in a Contractor business system—

(i) The Contractor shall, within 45 days of receipt of the notice, either correct the deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the deficiencies; and

(ii) (A) If the Contractor submits an acceptable corrective action plan within 45 days of receipt of a notice of the Contracting Officer's intent to withhold payments, and the Contracting Officer, in consultation with the Government auditor or functional specialist, determines that the Contractor is effectively implementing such plan, the Contracting Officer will reduce withholding directly related to the significant deficiencies covered under the corrective action plan, to two percent from progress payments and performance-based payments, and direct the Contractor, in writing, to reduce the percentage withheld on interim cost vouchers to two percent until the Contracting Officer determines the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination.

(B) If at any time the Contracting Officer determines that the Contractor has failed to follow the accepted corrective action plan, the Contracting Officer will increase withholding from progress payments and performance-based payments, and direct the Contractor, in writing, to increase the percentage withheld on interim cost vouchers to the percentage initially withheld, until the Contracting Officer determines that the Contractor has corrected all significant deficiencies as directed by the Contracting Officer's final determination.

* * * * *

(f) Correction of deficiencies. (1) The Contractor shall notify the Contracting Officer, in writing, when the Contractor has corrected the business system's deficiencies, and shall provide the Contractor's CPA audit report on the effectiveness of the corrective actions, if required by the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of this clause.

(2) Once the Contractor has notified the Contracting Officer that all deficiencies have been corrected and, if applicable, provided the Contractor's CPA audit report on the effectiveness of the corrective actions, the Contracting Officer will take one of the following actions:

(i) If the Contracting Officer determines that the Contractor has corrected all significant deficiencies as directed

by the Contracting Officer's final determination, the Contracting Officer will, as appropriate, discontinue the withholding of progress payments and performance-based payments, and direct the Contractor, in writing, to discontinue the payment withholding from billings on interim cost vouchers under this contract associated with the Contracting Officer's final determination, and authorize the Contractor to bill for any monies previously withheld that are not also being withheld due to other significant deficiencies, or noncompliance with applicable reporting and audit requirements in the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of this clause. Any payment withholding under this contract due to other significant deficiencies or noncompliance with applicable reporting and audit requirements, will remain in effect until the Contracting Officer determines that those significant deficiencies and noncompliances are corrected.

* * * * *

(g) Compliance with applicable reporting and audit requirements. When the Contractor has, as directed by the Contracting Officer's final determination, provided the Contractor's report on compliance with the system criteria, including, if applicable, the Contractor's CPA audit report as required in the applicable business system clause listed in the definition of "contractor business systems" in paragraph (b) of

this clause, the Contracting Officer will, as appropriate, discontinue the withholding of progress payments and performance-based payments, and direct the Contractor, in writing, to discontinue the payment withholding from billings on interim cost vouchers under this contract associated with the Contracting Officer's final determination, and authorize the Contractor to bill for any monies previously withheld that are not also being withheld due to significant deficiencies or other noncompliance with applicable reporting and audit requirements. Any payment withholding under this contract due to significant deficiencies or other noncompliance with applicable reporting and audit requirements, will remain in effect until the Contracting Officer determines that those significant deficiencies and noncompliances are corrected.

15. Amend section 252.242-7006 by—

- a. In the introductory text, removing "242.7503" and adding "242.7504" in its place;
- b. Removing the clause date "(FEB 2012)" and adding in its place "(DATE)";
- c. In paragraph (a) removing the numerical paragraph designations of (1) through (3) for the definition paragraphs, and adding, in alphabetical order, definitions for "Contractor's Certified Public Account (CPA)" and "CPA audit";
- d. Revising paragraph (b);

- e. Redesignating paragraphs (d), (e) and (f) as paragraphs (j), (k) and (l), respectively;
- f. Adding new paragraphs (d) through (i);
- g. Revising the newly redesignated paragraphs (j) and (k); and
- h. Amending the newly redesignated paragraph (l) by removing "252.242-7005" and adding "DFARS 252.242-7005" in its place.

The revisions and additions read as follows:

252.242-7006 Accounting System Administration.

* * * * *

(a) * * *

Contractor's Certified Public Accountant (CPA) means an independent certified public accountant, in public practice and not directly employed as an employee by the Contractor, performing audits for the Contractor in accordance with U.S. generally accepted government auditing standards (GAGAS) as issued by the Government Accountability Office.

CPA audit means an examination of the Contractor's compliance with the applicable system criteria in paragraph (c) of this clause performed by the Contractor's CPA in accordance with GAGAS for examination attestation engagements.

* * * * *

(b) General. The Contractor shall—

(1) Establish and maintain an acceptable accounting system;

and

(2) Make available to the Government, upon request, the results of internal or external reviews or monitoring that have been conducted to ensure compliance with the system criteria in (c) and established accounting system policies and procedures.

* * * * *

(d) Applicability. (1) Paragraph (e) of this clause applies if, in the Contractor's fiscal year preceding the period in which the annual report as required in paragraph (e) is due to the Government, the Contractor had a covered contract as defined in DFARS 242.7001 (other than contracts with educational institutions or Federally Funded Research and Development Centers (FFRDCs) operated by educational institutions).

(2) Paragraph (f) of this clause applies if, in the Contractor's fiscal year preceding the period in which the Contractor's CPA audit report as required in paragraph (f) is due to the Government, the Contractor had a covered contract as defined in DFARS 242.7001 (other than contracts with educational institutions or Federally Funded Research and Development Centers (FFRDCs) operated by educational institutions).

(e) Annual reporting requirements. (1) The Contractor shall provide to the Contracting Officer and Government auditor within the 6-month period following the expiration of the Contractor's fiscal year, and annually thereafter, a report regarding compliance with the system criteria in paragraph (c) of this clause as of the

end of the Contractor's most recent fiscal year. The Contractor shall have the report signed by an individual of the Contractor's organization at a level no lower than a vice president or chief financial officer of the reporting business segment.

(2) The report shall include—

(i) A statement that the Contractor has evaluated the accounting system's compliance with the system criteria in paragraph (c) of this clause;

(ii) The Contractor's assessment of the accounting system's compliance with the system criteria in paragraph (c) of this clause, including a statement as to whether or not the system complies in all material respects, and disclosure of any significant deficiencies with sufficient information for the Government to understand the deficiencies; and

(iii) The status of any significant deficiencies disclosed as part of the Contractor's assessment or, if applicable, in the Contractor's CPA audit report required in paragraph (f) of this clause, including a corrective action plan with milestones and actions to eliminate any significant deficiencies that have not been corrected as of the date of the Contractor's report.

(f) Triennial CPA audit requirement. (1) In the first year in which the Contractor is required to provide the annual report as required in paragraph (e) of this clause, and every three years thereafter, or more frequently if directed by the Contracting

Officer, in addition to the items in paragraphs (e)(2)(i), (ii), and (iii) of this clause, the Contractor's annual report shall include an audit report on the Contractor's CPA's examination of the Contractor's compliance with the system criteria in paragraph (c) of this clause as of the end of the Contractor's most recent fiscal year.

(2) The examination shall be performed in accordance with GAGAS for examination attestation engagements, and the CPA audit report shall include sufficient information regarding any reported significant deficiencies for the Government to understand the deficiencies.

(g) CPA selection. If paragraph (f) of this clause is applicable, the Contractor shall reasonably ensure that the CPA firm performing the audit is—

(1) Independent and objective with respect to the audited entity by obtaining and reviewing a written representation from the firm that the firm (and the assigned engagement team)—

(i) Is independent and objective with respect to the audited entity;

(ii) Will remain independent throughout the audit;

(iii) Has not performed any nonaudit services for the audited entity that impair the auditors' independence for the subject audit; and

(iv) Will disclose any independence issues discovered;
and

(2) Qualified to perform the audit by obtaining and reviewing—

(i) Information about key engagement team members regarding professional qualifications and experience, including valid CPA licenses or certificates in good standing, and current knowledge and experience in the type of work to be done; and

(ii) The firm's most recent peer review report, in accordance with the American Institute of Certified Public Accountants (AICPA) Peer Review Program, or equivalent.

(h) Contractor submission of audit plan. The Contractor shall provide the Contractor's CPA's audit strategy, risk assessment, and audit plan (program), upon completion, for the audits as required in paragraphs (f) and (k)(2) of this clause to the cognizant contracting officer and Government auditor for review if—

(1) The Contractor has more than \$100 million in cost incurred on cost-reimbursement and incentive type contracts, and amounts billed on time and material and labor hour contracts during the Contractor's fiscal year to which the Contractor's CPA audit report applies; or

(2) Requested by the Contracting Officer, in consultation with the Government auditor.

(i) Documentation requirements. (1) If paragraphs (e) and (f) of this clause are applicable, the Contractor shall maintain and make available to the Government upon request—

(i) Documentation to provide reasonable support for the assessment of the accounting system as required in paragraph (e)(2)(ii) of this clause; and

(ii) Information considered in the selection of a CPA as required in paragraph (g) of this clause, if applicable.

(2) The Contractor shall arrange for Government access to the working papers supporting the CPA audit reports as required in paragraphs (f) and (k)(2) of this clause, and documentation supporting the CPA's independence, objectivity, and qualifications.

(j) Significant deficiencies or failure to comply with applicable reporting and audit requirements. (1) The Contracting Officer will provide an initial determination to the Contractor, in writing, of any significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraphs (e) and (f) of this clause. The initial determination will describe the deficiency in sufficient detail to allow the Contractor to understand the deficiency and provide sufficient information on the noncompliance with the applicable reporting and audit requirements to allow the Contractor to understand what action needs to be taken to comply.

(2) The Contractor shall respond within 30 days to a written initial determination from the Contracting Officer that identifies significant deficiencies in the Contractor's accounting system or the Contractor's failure to comply with the applicable reporting and audit requirements in paragraphs (e) and (f) of this clause. If the Contractor disagrees with the initial determination, the Contractor shall state, in writing, its rationale for disagreeing.

(3) The Contracting Officer will evaluate the Contractor's response and notify the Contractor, in writing, of the Contracting Officer's final determination concerning—

- (i) Remaining significant deficiencies;
- (ii) Remaining noncompliance with the applicable reporting and audit requirements;
- (iii) The adequacy of any proposed or completed corrective action; and
- (v) System disapproval, if the Contracting Officer determines that one or more significant deficiencies remain or the Contractor has failed to comply with the applicable reporting and audit requirements.

(k) If the Contractor receives the Contracting Officer's final determination of significant deficiencies or the Contractor's failure to comply with the applicable reporting and audit requirements in accordance with paragraphs (e) and (f) of this clause, the Contractor shall—

(1) Within 45 days of receipt of the final determination, either correct the significant deficiencies or submit an acceptable corrective action plan showing milestones and actions to eliminate the significant deficiencies, and comply with the applicable reporting and audit requirements; and

(2) If the significant deficiencies were reported in the Contractor's annual report, or the Contractor's CPA audit report, provide the Contractor's CPA's opinion regarding the effectiveness of the corrective actions—

(i) As a part of the triennial CPA audit report as required in paragraph (f) of this clause; or

(ii) In a separate audit report on the Contractor's CPA's examination of the effectiveness of the corrective action performed in accordance with GAGAS for examination attestation engagements.

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