



## DOD-IG Semi-Annual Report Highlights DCAA Record Questioned Costs

By Michael Steen, CPA, Senior Director at Redstone Government Consulting, Inc.

In accordance with the Inspector General Act of 1978, the DoD-IG issues a Semi-Annual Report to Congress which describes not only its activities, but also those of the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA). With respect to DCMA, Appendix F, Status of Action on Post-Award Contracts, provides a snapshot of DCMA actions with respect to certain DCAA post-award audit reports (which exclude audits of contractor forward pricing and bid proposals). For the six months ending 9/30/2015, there were 1,813 open audit reports with costs questioned of \$12.527 billion. During that same period, 529 audit reports were closed (dispositioned) with contracting officers sustaining 31.3 percent (\$504 million of \$1,611 million). In comparison, the sustention rate for the period ending 9/30/2014 was 22.8 percent and the sustention rate for the period ending 3/31/2015 was 32.5 percent. Although the sustention rate has improved, it remains an industry concern given that prior to 2009, DCAA's overall sustention rate was typically 65 percent with sustention rates below 50 percent considered to be audits which failed to meet DCAA's quality standards.

In the opinion of this author, DCAA's current (relatively low) sustention rates speaks for themselves in terms of confirming that DCAA's objective is to maximize costs questioned with or without a solid regulatory basis for the reported exceptions. This DCAA strategy is evidenced in Appendix E, Contract Audit Reports Issued, which reported a record \$3.75 billion questioned costs for incurred costs and special audits for the six months ending 9/30/2015. Added to the data reported for the six months ending 3/31/2015, DCAA's questioned costs for incurred costs and special audits for Fiscal Year 2015 is \$4.81 billion (The data does not separately report incurred cost audits' results; however, it is safe to say that the majority of these questioned costs are from those audits of contractor claimed costs within the annual indirect cost rate proposals submitted as required by FAR 52.216-7(d)). It is equally safe to say that the incurred cost results are derived from a minority of contractor indirect cost rate proposals because DCAA, under its low-risk sampling plan, "writes off" without audit the majority of contractor indirect cost rate proposals.

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DCAA's stated and evidenced strategy is to focus on pay-back (return on investment) which involves auditing large indirect cost rate proposals and liberally questioning direct and indirect costs within those audits. The issues and the questioned costs are highlighted in Appendix H of the DOD-IG Report (Section 845 Annex Audit Reports with Significant Findings). For the period ending 9/30/2015, a sampling of those significant findings include audit reports:

- 6171-2008E101000009; \$23 million of noncompliant costs (questioned costs) including \$15.6 million of inadequately supported subcontract/direct materials and \$8 million for labor which failed to meet the contractual requirements. Editor comment: Although DCAA disclaimed an opinion on the overall costs, it is noteworthy that DCAA did question costs based upon its limited procedures. The implications, DCAA may now be embracing audit disclaimers; however, DCAA is not merely "walking away" from the audit. It's all about maximizing questioned costs.
- 6831-2008M101000003, \$12 million questioned costs, including \$5 million of unallowable subcontract costs (no other rationale provided by the DOD-IG), \$5 million of travel with inadequate supporting documentation, and \$1 million of relocation costs due to lack of supporting documentation.
- 1751-2007D101000001, \$47.5 million questioned costs, including \$9.9 million corporate allocations (assist audit), \$7.8 million of unsupported direct subcontract costs (assist audit), \$4.1 million of unallowable subcontract costs due to lack of competitive awards, \$6.8 million for unreasonable executive compensation, \$9.0 million for intercompany allocations (assist audit) and \$2 million for depreciation due to lack of supporting documentation. Editor comment: There is no FAR requirement for competitive subcontract awards although DCAA auditors make such assertions. With respect to depreciation, DCAA is likely requiring documentation including cancelled checks for equipment purchased years ago; thus, DCAA is ignoring the records retention requirements within FAR 4.705.
- 1241-2008L10100503, \$60.7 million questioned costs, including \$38.5 million of direct labor and other direct costs on T&M contracts because of lack of supporting documentation (e.g. labor qualifications), \$2 million because of an unrecorded credit, and \$17.3 million of unallowable direct subcontract costs because of FAR non-compliances and DFARS

deficiencies. Editor comment: DCAA is commonly asserting that prime contractors must "audit" subcontract costs even though there is absolutely no regulation which requires "audits" by prime contractors. See the next bullet.

- 6811-2006U101000001, \$74.6 million questioned costs, including \$52.2 million for direct labor, material and subcontract costs not allowable on the contract on which claimed, unreasonable, non-compliant with Cost Accounting Standards, and/or failure to audit the subcontract costs. \$9.4 million of Independent Research and Development (IR&D) costs for trade shows not supported by evidence of effort to promote foreign sales. Editor comment: No regulation requires prime contract "audits" of subcontract costs and with respect to IR&D, it's impossible to determine why these costs would have been charged to IR&D even though the costs might be allowable under FAR 31.205-1(d)(2), promoting the foreign sales of products/services normally sold to the US Government.
- 6831-2009B101000004, \$22 million questioned costs including \$8 million for travel (inadequate supporting documentation), \$7 million for consulting costs (inadequate documentation), and \$1.6 million of performance bonuses because of inadequate support for the awards. Editor comment: DCAA is routinely citing FAR 31.205-6(f)(2) which is the "basis for the award is supported"; however, DCAA expects this to include employee ratings along with an incentive compensation formula which then yields the amount of the award for each employee. Not surprisingly, nothing in FAR prescribes a "mathematical formula" in conjunction with supporting the basis for the award for incentive compensation.
- 6211-2009C179000006, \$16.6 million questioned costs for direct labor from 4/1/2006 to 1/31/2014 for employees who did not meet the labor qualifications (education or experience) contained in the T&M contract. Editor comment: See the second article in this newsletter and its link to a CP&A article concerning DCAA's strategy on T&M contract labor qualifications.

There are several more incurred cost audits listed in Appendix H with the most common explanation (for questioned costs) inadequate documentation. In some cases, DCAA may have a valid point; however, in many cases DCAA is injecting highly subjective and non-regulatory requirements such as prime



contractor “audits” of subcontract costs. In particular, very few FAR Cost Principles (FAR 31) explicitly require a particular form of documentation. Additionally, DCAA totally ignores FAR 4.705 which prescribes records retention periods for specific types of records; for example time-cards or their equivalent have a retention period of two-years (after the year of the transaction). Regardless, if/when DCAA actually performs a post-award audit of contractor incurred direct and indirect costs, it will be difficult for a large contractor to avoid issues involving millions of dollars. If DCAA has failed to correctly apply the regulations, it might be possible for the contractor to favorably resolve those issues with a reasonable contracting officer. Unfortunately, issue resolution may become more difficult once the DOD-IG completes its ongoing review of “DCMA actions to resolve and complete the disposition of DCAA audits of DOD contractor incurred costs” (announced November 6, 2015).

In addition to DCAA audits of contractor incurred costs, the semi-annual DOD-IG report for the period ending 9/30/2015 also includes data on Defective Pricing (TINA non-compliance) in the context of DCAA’s issuance of 23 audit reports with a total recommended price adjustment of \$148.3 million. Although 23 audits is undoubtedly less than 1 percent of the contracts subject to TINA, the results are a reminder that the risk of defective pricing is alive and well. Not stated in the DOD-IG report, that most defective pricing audits are also referred to an investigative agency as if the contractor knowingly submitted defective cost or pricing data. In other words, failure to comply with TINA can get ugly and expensive.

In summary, compliance with government contract terms and conditions is increasingly more challenging, at least for any contractor subjected to a DCAA after-the-fact incurred cost audit. For those contractors deemed low risk whose indirect cost rate proposals are written off (without audit) by DCAA, count your blessings, but recognize the need for disciplined and consistent accounting to maintain the low-risk designation.

## DCAA Auditors Challenging Contractor Labor Qualifications on T&M Contracts

*By Michael E. Steen, CPA, Senior Director at Redstone Government Consulting, Inc.*

In As mentioned in the preceding article, DCAA’s incurred cost audits routinely report direct labor questioned costs attributable to contractor employee qualification on T&M contracts. When these issues arise, DCAA questions all amounts billed for an employee whose documented qualifications (education and/or experience) fall short of those specified in the contract schedule. This ubiquitous issue is discussed in a CP&A Report (Cost, Pricing and Accounting) article, *DCAA Auditors Foraging Into The Qualifications of Contractor Employees Whose Services Have Been Invoiced*, which is available at the following link: [http://info.redstonegci.com/hubfs/Newsletters/CPA\\_11-1-1.pdf](http://info.redstonegci.com/hubfs/Newsletters/CPA_11-1-1.pdf) (Note the CP&A Article was co-authored by Jerome Gabig and Michael Steen; hence, the CP&A publisher allows us to post the article on the Redstone Government Consulting, Inc. website.)





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**August 22-23, 2016** – Cost and Price Analysis in Government Contracts

Arlington, VA

**August 25-26, 2016** – Government Contract Audits: Dealing with Auditors and Mitigating Audit Risk

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## CFO Roundtable

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Redstone Government Consulting, Inc., Radiance Technologies, Inc., & Warren Averett will be sponsoring a CFO/Controller roundtable for Government Contractors.

All Government contractor CFO's or Controllers are invited to participate. The meetings will be held quarterly beginning February 17, 2016 and will include lunch and networking from 11:30am – 1:00pm. The first meeting will be held in Research Park at the AEgis training facility located at 410 Jan Davis Drive, Huntsville, AL 35806. The second meeting will be held at Radiance Technologies located at 350 Wynn Drive Huntsville, AL 35805. Participants will be notified via email announcements for all future locations and seminar topics.

The CFO Roundtable is **free** to attend. All participants will be invited to share topics of interest and the group will be interactive. Redstone GCI, Radiance Technologies, and Warren Averett will strive to provide speakers on topics that are of interest to the group each quarter. Please provide us your email address and we will notify you 30 days in advance of each meeting. RSVP's are required.

Sign up for CFO Roundtable [here](#)

### About Redstone Government Consulting, Inc.

Our Company's Mission Statement: RGCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.

### Specialized Training

Redstone Government Consulting, Inc. will develop and provide specialized Government contracts compliance training for client / contractor audiences. Topics on which we can provide training include estimating systems, FAR Part 31 Cost Principles, TINA and defective pricing, cost accounting system requirements, and basics of Cost Accounting Standards, just to name a few. If you have an interest in training, with educational needs specific to your company, please contact Ms. Lori Beth Moses at [lmoses@redstonegci.com](mailto:lmoses@redstonegci.com), or at 256-704-9811.



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