



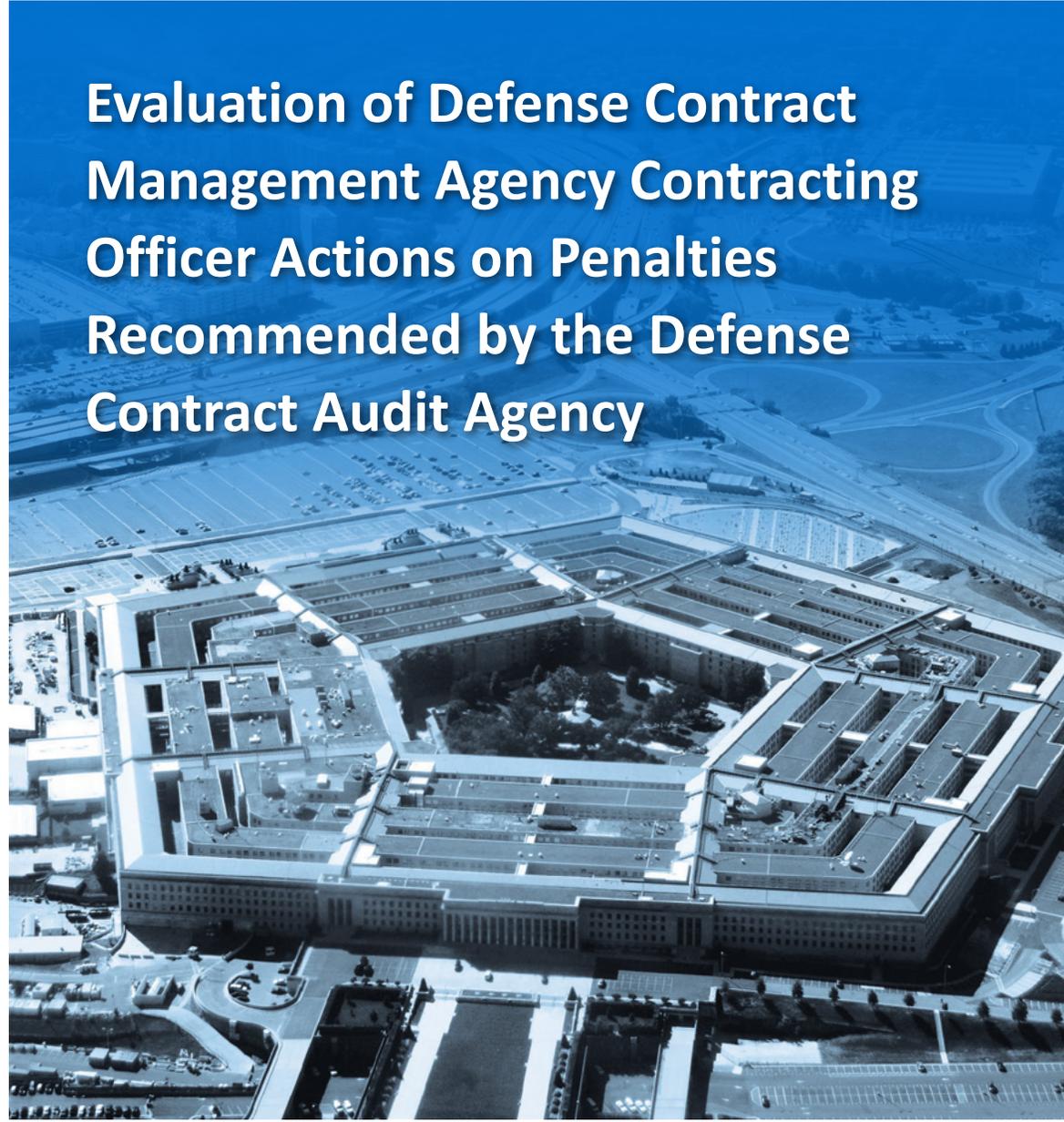
INSPECTOR GENERAL

U.S. Department of Defense

JANUARY 10, 2020



Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency



INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





Results in Brief

Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency

January 10, 2020

Objective

The objective of this evaluation was to determine whether Defense Contract Management Agency (DCMA) contracting officer actions complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy when the Defense Contract Audit Agency (DCAA) recommended penalties against DoD contractors for claiming unallowable indirect costs.

We evaluated DCMA contracting officer actions on 28 DCAA audit reports that recommended the assessment of penalties on \$154 million in indirect costs claimed by DoD contractors.

Background

Indirect costs benefit two or more of a DoD contractor's contracts. Examples of indirect costs include administrative employee salaries, leases, legal costs, and marketing costs. The FAR requires DoD contractors to submit an annual indirect cost rate proposal to the Government within 6 months following the close of each fiscal year. The contractor submits the proposal to claim actual indirect costs incurred on flexibly priced Government contracts and to reconcile the costs to amounts previously billed.¹ DoD contractors must exclude unallowable costs from the proposal and certify to the Government that all costs in the proposal are allowable.

¹ A flexibly priced contract is a type of Government contract in which a contractor is paid for all allowable incurred costs to the extent prescribed in the contract, plus profit.

Background (cont'd)

The FAR identifies the costs that are unallowable (also referred to as "expressly unallowable") on Government contracts. For example, the FAR states that costs of influencing legislation are unallowable on Government contracts.

The FAR requires DoD agencies to assess penalties and interest against DoD contractors that include expressly unallowable costs in DoD contractor indirect cost proposals. In most instances, the penalties are equal to the amount of expressly unallowable costs allocated to Government flexibly priced contracts over \$750,000. The FAR also states that the agencies may waive the penalties and interest if certain conditions are met, such as when the unallowable costs subject to penalty equal \$10,000 or less.

DCAA audits DoD contractor indirect cost proposals to determine if the claimed costs are allowable and comply with the FAR, the Defense Federal Acquisition Regulation Supplement, and contract terms. If the DCAA audit discloses any expressly unallowable costs, DCAA recommends that the contracting officer assess penalties and interest against the DoD contractor.

DCMA contracting officers are responsible for taking action on DCAA audit recommendations, including the assessment of penalties and interest. Contracting officers must document adequate rationale in the negotiation memorandum when they do not sustain the DCAA recommendations.² After considering the DCAA recommendations, the contracting officer negotiates an indirect cost rate agreement with the DoD contractor, which includes the indirect rates that the DoD contractor must use to close DoD contracts.

Findings

For 18 of 28 DCAA audit reports we selected, DCMA contracting officers did not adequately explain why they disagreed with DCAA's recommendations to assess penalties on \$43 million in unallowable indirect costs. The contracting

² The negotiation memorandum refers to the contracting officer's documented results of the negotiation with the contractor on the audit findings.



Results in Brief

Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency

Findings (cont'd)

officers documented adequate rationale for the actions they took on the remaining \$111 million (\$154 million less \$43 million) in costs that DCAA reported as unallowable and subject to penalties.

The DCMA contracting officers for the 18 audit reports documented one or more of the following reasons for not assessing penalties on the \$43 million in expressly unallowable costs reported by DCAA:

- For \$32 million, the contracting officers determined that the costs were not subject to penalties. However, the DCMA contracting officers did not document adequate rationale for disagreeing with DCAA that the costs were unallowable and subject to penalties.
- For \$11 million, the contracting officers determined that the costs met the FAR criteria for waiving penalties. However, the DCMA contracting officers did not document adequate rationale to show that the DoD contractor met the FAR criteria for waiving penalties.

Therefore, in the case of the 18 reports, the contracting officers did not comply with the FAR requirement that contracting officers document adequate rationale when they disagree with DCAA recommendations.

We concluded that this noncompliance occurred for the following reasons:

- insufficient training in assessing and waiving penalties and interest,
- failure to obtain a required legal review,
- failure to obtain DCAA's opinion on additional information received after audit report issuance, and
- ineffective supervisor reviews of the contracting officers' actions.

As a result, the contracting officers did not collect penalties on \$43 million in costs that may have been unallowable and subject to penalties. Furthermore, when contracting officers do not assess penalties, they diminish the incentive for DoD contractors to exclude expressly unallowable costs from indirect cost proposals submitted to the Government.

In addition, for seven contracting officers who upheld DCAA's recommendation to assess penalties, the contracting officers did not assess the correct amount of penalties. Finally, eight contracting officers did not assess the correct amount of interest due to the Government. We concluded that these deficiencies occurred because DCMA contracting officers were not consistently trained on correctly calculating penalties or interest.

Recommendations

We recommend that DCMA provide training to contracting officers and supervisors covering the requirements for identifying expressly unallowable costs and for assessing and waiving penalties in the Federal Acquisition Regulation 42.709. In addition, we recommend that DCMA reevaluate the contracting officers' decisions not to assess penalties on the \$43 million, take steps to recoup any expressly unallowable costs not previously disallowed, and obtain payment from the contractor for any penalties due to the Government.



Results in Brief

Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency

Management Comments and Our Response

The Defense Contract Management Agency Director agreed with three recommendations and partially agreed with two recommendations. Specifically, the Director agreed to assess the adequacy of the current training provided to contracting officers and supervisors related to the assessment of penalties and interest and to make any necessary improvements to the training.

In addition, DCMA will review the 18 DCAA audit reports in which contracting officers did not document adequate rationale and attempt to recoup any unallowable costs and assess penalties and interest.

Finally, the DCMA Director stated that DCMA will evaluate the eight instances in which DCMA contracting officers incorrectly calculated penalties and interest and, if necessary, attempt to recoup any additional penalties and interest due to the Government.

The DCMA Director's comments addressed the specifics of all five recommendations; therefore, the recommendations are resolved but will remain open. We will close the recommendations once we verify that the DCMA has implemented its planned corrective actions.

Please see the Recommendation Table on the next page for the status of the recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Defense Contract Management Agency Director	None	A.1, A.2, A.3, B.1, and B.2	None

Note: The following categories are used to describe agency management’s comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

January 10, 2020

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

SUBJECT: Evaluation of Defense Contract Management Agency Contracting Officer
Actions on Recommended Penalties by the Defense Contract Audit Agency
(Report No. DODIG-2020-049)

This final report provides the results of the DoD Office of Inspector General's evaluation. We previously provided copies of the draft report and requested written comments on the recommendations. We considered management's comments on the draft report when preparing the final report. These comments are included in the report.

The Defense Contract Management Agency Director agreed to address the recommendations presented in the report; therefore, the recommendations are considered resolved and open. As described in the Recommendations, Management Comments, and Our Response sections of this report, the recommendations may be closed when we receive adequate documentation showing that all agreed-upon actions to implement the recommendations have been completed. Therefore, within 90 days, please provide us your response concerning specific actions in process or completed on the recommendations. Your response should be sent to followup@dodig.mil.

If you have any questions, please contact [REDACTED]

A handwritten signature in black ink, appearing to read "Randolph R. Stone", is positioned above the typed name.

Randolph R. Stone
Assistant Inspector General for Evaluations
Space, Intelligence, Engineering, and Oversight

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Introduction

Objective

The objective of this evaluation was to determine whether Defense Contract Management Agency (DCMA) contracting officer actions complied with the applicable Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy when the Defense Contract Audit Agency (DCAA) recommended penalties against DoD contractors for claiming unallowable indirect costs.

We evaluated DCMA contracting officer actions taken between April 1, 2016, and March 30, 2018, on 28 DCAA audit reports that recommended the assessment of penalties against the DoD contractors for claiming \$154 million in unallowable indirect costs. See Appendix A for a discussion of our scope and methodology.

Background

The FAR is the primary regulation that all Federal Executive agencies must follow when they acquire supplies and services. FAR clause 52.216-7 requires contractors to submit an annual indirect cost rate proposal to the Government within 6 months following the close of the DoD contractor's fiscal year.³ The contractor submits the proposal to claim actual indirect costs incurred on Government contracts and to reconcile them to amounts previously billed. The contractor is required to identify and exclude unallowable costs from its indirect cost rate proposal in accordance with FAR 31.201-6(a).⁴ Indirect costs are costs that benefit two or more contracts. Examples of indirect costs include administrative employee salaries, leases, legal costs, and marketing.

FAR 42.703-2 requires DoD contractors to certify that the indirect cost proposals submitted to the Government include only allowable costs.⁵ FAR 31.205 identifies the costs that are unallowable on Government contracts.⁶ For example, FAR 31.205-22 states that costs associated with attempts to influence legislation or an election are unallowable on Government contracts.⁷ FAR 31.205 must specifically state that a cost is unallowable for it to be subject to penalties. Costs that are subject to penalties are also commonly referred to as expressly unallowable costs.

³ FAR Clause 52.216-7, "Allowable Cost and Payment."

⁴ FAR 31.201-6(a), "Accounting for Unallowable Costs."

⁵ FAR 42.703-2, "Certificate of Indirect Costs."

⁶ FAR 31.205, "Selected Cost."

⁷ FAR 31.205-22, "Lobbying and Political Activity Costs."

The FAR Requires the Assessment of Penalties and Interest if Contractors Claim Unallowable Costs

According to FAR 42.709, which implements paragraphs a. through d., Title 10, United States Code (10 U.S.C § 2324 [1995]), DoD agencies must assess penalties and interest against DoD contractors that include expressly unallowable costs in indirect cost proposals submitted to the Government.⁸ However, FAR 42.709-5 also requires that contracting officers waive penalties when certain conditions are met. For example, it requires the contracting officer to waive penalties when the contractor demonstrates that (1) it has established policies and internal controls which provide assurance that unallowable costs are excluded from an indirect cost rate proposal, and (2) the unallowable costs subject to the penalty were inadvertently included in the proposal.

Unless penalties are waived, the amount of the penalty is normally equal to the amount of the expressly unallowable costs allocated to Government contracts that are subject to penalties. Government contracts that are subject to penalties include Government flexibly priced contracts in excess of \$750,000.⁹ If the expressly unallowable costs were determined to be unallowable before submitting the proposal, the penalty is equal to two times the amount of the expressly unallowable costs. For example, the penalty is two times the amount of the expressly unallowable costs if the contract terms stipulate that a particular cost is unallowable or when the contracting officer notifies the contractor that a particular cost is unallowable before the contractor submits its proposal. FAR 42.709-4 also requires that contracting officers charge interest on the expressly unallowable costs that the Government paid to the contractor.¹⁰

DCAA Audits Contractor Indirect Cost Proposals and Recommends the Assessment of Penalties

DCAA performs contract audits for the DoD in accordance with DoD Directive 5105.36 and reports to the Under Secretary of Defense (Comptroller)/Chief Financial Officer.¹¹ DCAA performs several types of contract audits, including audits of DoD contractor indirect cost rate proposals. DCAA audits indirect cost rate proposals to determine whether the DoD contractor's indirect costs claimed on Government contracts are allowable and reasonable based on the FAR, the Defense Federal Acquisition Regulation Supplement, Cost Accounting Standards, and contract terms. When auditing an indirect cost rate proposal,

⁸ FAR 42.709, "Penalties for Unallowable Costs."

⁹ A flexibly priced contract is a type of Government contract in which a contractor is paid for all allowable incurred costs to the extent prescribed in the contract, plus profit.

¹⁰ FAR 42.709-4, "Computing Interest."

¹¹ DoD Directive 5105.36, "Defense Contract Audit Agency," January 4, 2010.

DCAA recommends the assessment of penalties if the audit identifies costs in the proposal that are unallowable according to FAR 31.205. In FY 2018, DCAA recommended penalties on \$211 million in expressly unallowable costs claimed by DoD contractors in indirect cost rate proposals submitted to the Government.

DCMA Takes Action on DCAA Audit Reports That Recommend Penalties

DCMA operates in accordance with DoD Directive 5105.64 and functions under the authority, direction, and control of the Under Secretary of Defense for Acquisition and Sustainment.¹² DCMA works directly with DoD contractors to ensure that Government supplies and services are delivered on time and at the projected cost. In its role as the contract administration office outlined in FAR subpart 42.3, DCMA is responsible for several contract administrative functions, such as approving or disapproving DoD contractor business systems and establishing final indirect cost rates.¹³ The final indirect cost rate applies to a specific time period that is based on the actual, allowable costs of that period which the Government and the contractor agreed to be applied to contracts.

In most cases, DCMA contracting officers are responsible for taking action on DCAA audit reports that recommend the assessment of penalties against the contractor for including the expressly unallowable costs in indirect cost rate proposals. The contracting officer documents the actions on the DCAA audit report in a negotiation memorandum. Once the contracting officer completes the negotiations with the contractor on the incurred cost rate proposal, the contracting officer executes an indirect cost rate agreement, which is a binding agreement between the DoD contractor and the Government on the indirect rates that the DoD contractor must use to close flexibly priced Government contracts.

FAR 42.705-1(b)(5)(iii)(C) and DoD Instruction 7640.02 require contracting officers to include any reasons why the recommendations of the auditor were not followed in the negotiation memorandum.¹⁴ DCMA Instruction 125 reiterates these requirements and emphasizes that contracting officers must include sound rationale in the negotiation memorandum when they disagree with audit findings and recommendations, including any recommendations for assessing penalties.¹⁵

¹² DoD Directive 5105.64, "Defense Contract Management Agency," January 10, 2013.

¹³ FAR Subpart 42.3, "Contract Administration Office Functions."

¹⁴ FAR 42.705-1(b)(5)(iii)(C), "Contracting Officer Determination Procedure," and DoD Instruction 7640.02, "Policy on Follow-up of Contract Audit Reports," Enclosure 3, paragraph 3(b).

¹⁵ DCMA Instruction 125, "Final Overhead Rates," April 21, 2014.

We Selected 28 DCAA Audit Reports That Recommended Penalties

As part of our evaluation, we selected 28 of the 358 DCAA audit reports that recommended the assessment of penalties and addressed by contracting officers from April 1, 2016, to March 30, 2018. We selected the 28 reports that contained significant amounts of questioned costs subject to penalties. For the 28 DCAA audit reports that we selected, DCAA recommended the assessment of penalties on \$154 million in costs that DCAA identified as expressly unallowable. The DCAA auditors determined that the costs were unallowable and subject to penalties based on the requirements of FAR 31.205. The majority of the expressly unallowable costs involved labor, consulting and professional services, travel, legal costs, and donations.

For example, in Audit Report No. 3121-2012K10100001, DCAA questioned \$532,138 in donations paid to an educational institution as unallowable in accordance with FAR 31.205-8, "Contributions and Donations." FAR 31.205-8 states that contributions or donations, regardless of the recipient, are unallowable. Accordingly, DCAA recommended that the contracting officer assess penalties against the DoD contractor for claiming the donations in its indirect cost rate proposal. Table 1 shows a breakdown of the DCAA questioned costs subject to penalty by type, and the applicable FAR parts associated with the 28 audit reports.

Table 1. DCAA Questioned Costs Reported as Unallowable and Subject to Penalties (In Millions)

Type of Questioned Costs	No. of Reports ¹	Questioned Costs Subject to Penalties ²	FAR Reference
Labor	15	\$37	FAR 31.205-6, "Compensation for Personal Services"
Consulting	18	31	FAR 31.205-33, "Professional and Consultant Service Costs"
Travel or Per Diem	13	17	FAR 31.205-14, "Entertainment Costs"
Legal	10	12	FAR 31.205-47, "Legal and Other Proceedings"
Advertising/ Memberships dues	11	5	FAR 31.205-1, "Public Relations and Advertising Costs"
Entertainment Costs	12	3	FAR 31.205-14, "Entertainment Costs"
Merger and Acquisition Costs	6	3	FAR 31.205-27, "Organizational Costs"
All Other Cost Types	25	46	Other parts of FAR 31.205, "Selected Costs"
Total		\$154	

¹ The number of reports with questioned costs does not total 28 because several of the reports included multiple types of questioned costs.

² individual questioned cost is rounded.

Source: DoD OIG, based on DCAA data.

Finding A

DCMA Contracting Officers Did Not Adequately Explain Why They Disagreed With DCAA's Recommendation to Assess Penalties

For 18 of the 28 DCAA audit reports we selected, DCMA contracting officers did not adequately explain why they disagreed with DCAA's recommendations to assess penalties on indirect costs of \$43 million. The DCMA contracting officers for the 18 audit reports provided the following explanations for not assessing penalties on the \$43 million in expressly unallowable costs reported by DCAA.

- For \$32 million, the contracting officers determined that the costs were not subject to penalties as DCAA had reported. However, the contracting officers' explanations for determining that the costs were not subject to penalties were inconsistent with FAR 31.205, which identifies the types of costs that are subject to penalties.
- For the remaining \$11 million, the contracting officers determined that the contractors met the FAR criteria for waiving the penalties. However, the explanations for waiving the penalties were inconsistent with FAR 42.709-5, which identifies the criteria for waiving penalties.

These reasons do not adequately justify why the contracting officers disagreed with DCAA on the assessment of penalties. Therefore, the contracting officers did not comply with FAR 42.705-1(b)(5)(iii)(c), which requires contracting officers to document adequate rationale for disagreeing with DCAA recommendations. This occurred because of:

- insufficient training in assessing penalties and interest;
- failure to obtain a required legal review;
- failure to obtain DCAA's opinion on additional information received after audit report issuance, as FAR 42.705-1(b)(4)(i)(B) requires; and
- ineffective supervisory reviews of the contracting officers' actions.

As a result, the contracting officers did not collect penalties on \$43 million in costs that may have been unallowable and subject to penalties, contrary to FAR 42.709.

For \$23 million of the \$43 million, the contracting officers also did not disallow the costs that DCAA had reported were expressly unallowable in accordance with FAR 31.205. The failure of contracting officers to assess and impose penalties, when appropriate, diminishes the incentive of DoD contractors to exclude expressly unallowable costs from incurred cost proposals and increases the risk or likelihood of the DoD paying for costs that are unallowable under public law.

DCMA Contracting Officers Did Not Adequately Explain Why They Disagreed With the DCAA

For 18 of the 28 DCAA audit reports that we reviewed, DCMA contracting officers did not adequately explain why they disagreed with \$43 million of the \$154 million that DCAA reported was unallowable and subject to penalties. The contracting officers documented adequate rationale for the actions they took on the remaining \$111 million (\$154 million less \$43 million) in costs that DCAA reported as unallowable and subject to penalties. Table 2 shows the DCAA-reported questioned costs subject to penalties and the contracting officer's determination, broken out by the adequacy of the contracting officer rationale.

Table 2. DCAA Questioned Costs Subject to Penalty, Contracting Officer Determination, and Adequacy of the Contracting Officer's Rationale (Rounded In Millions)

Adequacy of Contracting Officer Rationale	DCAA Report	Contracting Officer Determination		
	Costs Subject to Penalty	Costs Subject to Penalty	Costs Not Subject to Penalty	Penalties Waived
Inadequate Rationale	\$43	0	32	11
Adequate Rationale	111	40	55	16
Total	\$154	\$40	\$87	\$27

Appendix B identifies the DCAA audit reports in which DCMA contracting officers did not document adequate rationale for disagreeing with DCAA's reported questioned cost subject to penalties.

In most instances, the contracting officers documented one or both of the following reasons for not assessing penalties on the \$43 million in expressly unallowable costs reported by DCAA.

- For \$32 million, the contracting officers determined that the costs were not subject to penalties as DCAA had recommended. However, the contracting officers' explanations for determining that the costs were not subject to penalties were inconsistent with FAR 31.205, which identifies the types of costs that are subject to penalties.
- For the remaining \$11 million, the contracting officers determined that the contractors met the FAR criteria for waiving the penalties. However, the explanations for waiving the penalties were not consistent with FAR 42.709-5, which identifies the criteria for waiving penalties.

As discussed below, we determined that these reasons do not adequately explain why the contracting officers disagreed with DCAA on the assessment of penalties.

Contracting Officers Did Not Document Adequate Rationale for Determining That \$32 Million in Questioned Costs Were Not Subject to Penalties

Of the \$154 million in questioned costs subject to penalties reported by DCAA, the contracting officers determined that \$87 million in costs were not subject to penalty. For \$32 million of the \$87 million, the contracting officers did not document adequate rationale for explaining why they did not uphold the DCAA recommendations, as FAR 42.705-1(b)(5)(iii) and DoD Instruction 7640.02 require. For \$23 million of the \$32 million, the contracting officers did not uphold DCAA's recommendation to disallow the costs or assess penalties. For the remaining \$9 million, the contracting officers upheld DCAA's recommendation to disallow the costs, but they did not uphold DCAA's recommendation to assess penalties.

For example, in Audit Report No. 3221-2010T10100001, DCAA questioned \$1.4 million of a DoD contractor's legal costs incurred in connection with filing a lawsuit for a breach of contract arising from a joint venture. FAR 31.205-47(f)(5)(i) states that:

[c]osts not covered elsewhere in this subsection are unallowable if incurred in connection with costs of legal, accounting, and consultant services and directly associated costs incurred in connection with the defense or prosecution of lawsuits or appeals between contractors arising from an agreement or contract concerning a teaming arrangement, a joint venture, or similar arrangement of shared interest.¹⁶

The contracting officer appropriately disallowed the contractor's claim for reimbursement of the \$1.4 million, but determined that it was not subject to penalties. The contracting officer explained in the negotiation memorandum that, because the actual subject matter of the lawsuit had no relationship to a Government contract, penalties were not appropriate. The contracting officer had obtained a legal opinion from a DCMA attorney who determined that the legal costs were unallowable and subject to penalties, regardless of whether the lawsuit involved a Government contract. However, the contract file does not include an explanation of why the contracting officer decided not to follow the legal advice and assess penalties against the contractor.

We disagree with the contracting officer's decision not to assess penalties. FAR 31.205-47(f)(5)(i) does not stipulate that the legal dispute must involve a Government contract. The contracting officer should have assessed penalties because FAR 31.205-47(f)(5)(i) explicitly states that such legal costs are

¹⁶ FAR 31.205-47(f)(5)(i), "Costs Related to Legal and Other Proceedings."

unallowable. The negotiation memorandum did not provide adequate rationale for disagreeing with the DCAA audit report or the DCMA attorney's advice to assess penalties against the contractor.

When we asked the contracting officer, he stated that a reasonable person could interpret the FAR to mean that legal costs are unallowable only if they involve disputes over a Government contract. However, the FAR clearly states that the types of legal costs claimed by the contractor are expressly unallowable and subject to penalties. Therefore, the contracting officer's rationale for disagreeing with the DCAA audit report and the DCMA legal opinion did not comply with FAR 42.705-1(b)(5)(iii)(B). As a result of not assessing penalties, the contracting officer did not collect approximately \$412,000 in penalties plus interest.

For the remaining \$30.6 million (\$32 million less \$1.4 million), the contracting officers similarly did not document adequate rationale for disagreeing that the DCAA questioned costs were subject to penalties. Therefore, the contracting officers did not comply with:

- the FAR 42.705-1(b)(5)(iii)(C) requirement for documenting adequate rationale when they disagree with DCAA recommendations; and
- the FAR 42.709-1(a)(1) requirement for assessing penalties.

As a result, the contracting officers failed to justify why they did not assess penalties on the \$32 million that may have been due to the Government. In addition, the contracting officers failed to justify why they decided not to disallow \$23 million of the \$32 million in expressly unallowable costs reported by DCAA.

Contracting Officers Did Not Justify Waiving Penalties on \$11 Million in Questioned Costs

For \$27 million of the \$154 million that DCAA identified as questioned costs subject to penalties, the contracting officers disallowed the contractor's claim for reimbursement of the questioned costs, but they elected to waive the associated penalties. Of the \$27 million, the contracting officers did not document adequate rationale to justify waiving penalties on \$11 million in questioned costs subject to penalties.

For example, in Audit Report No. 6631-2012C10100003, DCAA questioned \$2.9 million of the contractor's claimed consultant costs and determined that the costs were subject to penalties. The questioned costs included:

- lobbying activities with congressional members and Executive branch officials,

- life insurance on the contractors' executives, and
- media efforts to enhance the contractor's public image.

DCAA reported that the claimed costs were expressly unallowable and subject to penalties in accordance with FAR 31.205-22, FAR 31.205-19, and FAR 31-205.1.¹⁷

The contracting officer appropriately disallowed all of the DCAA questioned costs but decided to waive the penalties. In the negotiation memorandum, the contracting officer explained that she waived the penalties because the contractor inadvertently included the costs in its indirect cost rate proposal. She also stated in the negotiation memorandum that the contractor should establish a practice to exclude expressly unallowable costs from indirect cost rate proposals in the future.

Although the contracting officer did not document it in the negotiation memorandum, she received legal advice from a DCMA attorney before she made her final decision. The DCMA attorney advised that the costs were subject to penalties, as DCAA had reported. The attorney also advised the contracting officer that the contractor did not meet the two criteria for waiving the penalties. First, the attorney questioned whether the contractor had inadvertently included the expressly unallowable costs in its proposal because the contractor had a history of including similar costs in prior proposals. Second, the attorney stated that the contractor had not established policies, personnel training, or internal control systems to assure that expressly unallowable costs would be excluded from future proposals. Despite the DCMA attorney's advice, along with the DCAA report recommendations, the contracting officer ultimately decided not to assess penalties against the contractor.

When we asked the contracting officer why she did not follow the DCMA legal advice, she stated, "[i]t is the contracting officer's understanding that we reach out to DCMA legal for advice that may be considered during the settlement process. However, this advice does not mandate the contracting officer's position."

We recognize the contracting officer's independence in making a determination, despite the expert advice she received from DCMA legal attorney and DCAA. Nevertheless, contracting officers have an obligation to demonstrate that their determinations comply with the FAR and any other applicable requirements.

In this case, the contracting officer did not document adequate rationale for waiving the penalties in accordance with the FAR criteria. To waive penalties, FAR 42.709-5(c)(2) requires the establishment that the contractor inadvertently included these costs in its indirect cost proposal. The contracting officer did not

¹⁷ FAR 31.205-19, "Insurance and Indemnification," and FAR 31-205.1, "Public Relations and Advertising."

explain how this criterion was met, especially considering that the DCMA attorney had questioned whether the costs were inadvertently included. Moreover, the contracting officer did not adequately document whether the contractor met the second criterion, in FAR 42.709-5(c)(1), which requires verifying that the contractor has established practices, training, and systems to ensure the exclusion of unallowable costs. The contracting officer stated in the negotiation memorandum that the contractor should meet this criteria, but she failed to verify and document whether the contractor actually met the criteria, as the FAR requires.

Therefore, the contracting officer inappropriately waived penalties on \$2.9 million in expressly unallowable costs. As a result, the contracting officer did not collect approximately \$1.8 million of penalty based on the amount of the \$2.9 million allocable to Government contracts subject to penalties.¹⁸

The contracting officer told us that she was familiar with the requirements of the FAR for assessing and waiving penalties. The contracting officer stated that she believes the contractor provided sufficient assurance that it had reliable practices in place to avoid the inclusion of expressly unallowable costs in proposals. However, the contracting officer did not meet her burden of obtaining and documenting sufficient evidence that the practices were in place and operating effectively.

For the remaining \$8.1 million (\$11 million less \$2.9 million), the contracting officers similarly waived penalties on the DCAA-reported expressly unallowable costs without documenting adequate rationale. Therefore, we concluded that the contracting officers did not comply with the FAR criteria for waiving penalties.

Contracting Officers Adequately Explained Their Actions on \$111 Million of the DCAA Penalty Recommendations

Of the \$154 million in questioned costs subject to penalties reported by DCAA, contracting officers adequately explained in the negotiation memorandum the actions they took on \$111 million of the costs. The contracting officers either sustained the DCAA recommendations and assessed penalties, determined that the questioned costs were not subject to penalties, or determined that the questioned costs were subject to penalties but decided to waive them. When the contracting officers disagreed with DCAA or waived the penalties, they documented adequate rationale for their actions in accordance with FAR 42.705(b)(5)(iii)(C) and FAR 43.709-5.

¹⁸ Government contracts that are subject to penalties include Government flexibly priced contracts in excess of \$750,000.

For example, in Audit Report No. 2801-2011B10100001, DCAA reported that \$7.2 million of the contractor's proposed consultant costs were expressly unallowable and subject to penalties primarily in accordance with FAR 31.205-33 because the contractor did not provide consultant agreements, statements of work, or a work product to support the claimed costs.¹⁹

Of the \$7.2 million, the contracting officer sustained the DCAA recommendations by determining that \$1 million was subject to penalties in accordance with multiple parts of FAR 31.205, such as FAR 31.205-1, FAR 31.205-22, and FAR 31.205-46.²⁰

For the remaining \$6.2 million, the contracting officer determined that:

- \$1.9 million was allowable on Government contracts and it was, therefore, not subject to penalty.
- \$4.3 million was not allowable on Government contracts, but it was not subject to penalties because the FAR did not explicitly state that these costs were unallowable.

The contracting officer explained in her negotiation memorandum that she did not disallow the \$1.9 million because the contractor provided the consultant's work product after DCAA issued its audit report. The contracting officer documented her review of the work product in the negotiation memorandum, which detailed descriptions of the consultant's work, management briefings, and business strategies. Therefore, the contracting officer appropriately concluded that the work product met the requirements in FAR 31.205-33(f)(3), which states that fees for services rendered are allowable only when supported by evidence of the nature and scope of the service furnished.

The contracting officer also explained that she disallowed another \$4.3 million because the contractor failed to provide a work product to support the nature and scope of the services furnished. However, she did not assess penalties because FAR 31.205-33(f)(3) does not explicitly state that consultant costs are unallowable due to the lack of supporting documentation, such as a work project.

We determined that the contracting officer took the appropriate actions to address the \$7.2 million of DCAA-questioned costs subject to penalties. We agree with the contracting officer that \$6.2 million (including the \$1.9 million and the \$4.3 million) of the costs were not subject to penalties in accordance with an accurate interpretation of the FAR 31.205-33(f)(3).

¹⁹ FAR 31.205-33, "Professional and Consultant Service Costs."

²⁰ FAR 31.205-1, "Public Relation and Advertising," and FAR 31.205-46, "Travel Costs."

Factors That Contributed to the Contracting Officers' Failure to Document Adequate Rationale

We identified four factors that contributed to the failure of contracting officers to document adequate rationale when they disagreed with DCAA penalty recommendations. Specifically, contracting officers did not receive training, did not obtain a required legal opinion, did not obtain DCAA's opinion regarding additional information received after the DCAA report, or supervisors did not adequately oversee contracting officer actions. Appendix C identifies the factors applicable to each report.

Contracting Officers Did Not Receive Training on Identifying Costs Subject to Penalties and Assessing or Waiving Penalties

For 12 of the 18 audit reports for which contracting officers did not document adequate rationale, the contracting officers did not receive training for identifying costs that are subject to penalties in accordance with FAR 31.205, or for assessing and waiving penalties in accordance with FAR 42.709. Without training, contracting officers are less likely to comply with the FAR requirements for assessing penalties or documenting adequate rationale when they disagree with DCAA penalty recommendations.

For example, in Audit Report No. 1461-2009D10100001, DCAA reported that \$1.2 million in trade show costs were expressly unallowable and subject to penalties in accordance with FAR 31.205-1(f)(2), which states that unallowable public relations costs include all costs of trade shows and other special events which do not contain a significant effort to promote export sales.²¹ DCAA concluded that the costs did not involve a significant effort to promote export sales.

The negotiation memorandum states that the contracting officer determined that \$1.1 of the \$1.2 million of trade show costs were allowable, but the memorandum does not include a basis for determining that the costs were allowable. We held discussions with the contracting officer, who did not appear to have a clear understanding of the types of public relations costs that are allowable and unallowable. The contracting officer stated that she did not recall receiving any training on identifying costs that were subject to penalties or assessing and waiving penalties. We obtained the contracting officer's training records, which confirmed that she had not received any related training. Therefore, DCMA should provide training to contracting officers on the requirements for identifying unallowable costs in FAR 31.205 and for assessing and waiving penalties in FAR 42.709.

²¹ FAR 31.205-1(f)(2), "Public Relations and Advertising Costs."

Contracting Officers Did Not Obtain a Required Legal Opinion

For 14 of the 18 audit reports when contracting officers did not document adequate rationale, the contracting officers did not consult legal counsel prior to negotiating the DCAA-questioned costs. DoD Instruction 7640.02, Enclosure 3, paragraph 3(b), requires that contracting officers consult legal counsel and document the legal basis when their disagreement with DCAA findings or recommendations is based on an interpretation of law or regulation. In all 14 instances, the contracting officers' disagreement was based on an interpretation of the FAR that differed from DCAA's interpretation.

For example, in Audit Report No. 3711-2009A10100001, DCAA questioned \$725,000 in expressly unallowable consulting costs based on FAR 31.205-33(c)(3) and recommended the assessment of penalties.²² The contracting officer agreed to disallow the consultant costs, but disagreed that the costs were subject to penalties based on his different interpretation of FAR 31.205-33(c)(3). Even though the contracting officer's interpretation of the FAR was different from DCAA's, the contracting officer did not seek a legal opinion on his interpretation of the FAR, as DoD Instruction 7640.02 requires.

When contracting officers do not obtain a required legal review, they bypass a key control established by the DoD and DCMA to help ensure that contracting officer determinations comply with applicable regulations and DoD policy. Therefore, we concluded that a lack of obtaining legal review contributed to contracting officers not documenting adequate rationale for disagreeing with DCAA on the assessment of penalties.

Contracting Officers Did Not Obtain DCAA's Opinion on Additional Contractor Information

For 12 of the 18 audit reports, the contracting officers received additional information from contractors to dispute DCAA's questioned costs subject to penalty. Of the 12 contracting officers, 9 could not provide evidence that they had consulted with DCAA on the additional information.

FAR 42.705-1(b)(4)(i)(B) states that contracting officers must not resolve any DCAA-questioned costs until they obtain DCAA's opinion on the allowability of Government contract costs. In addition, DCMA Instruction 125 requires contracting officers to obtain the auditor's opinion on additional documentation they receive from contractors after issuance of the DCAA audit report. The Instruction also requires contracting officers to document the auditor's opinion on the additional information in a memorandum for record.

²² FAR 31.205-33(c)(3), "Professional and Consultant Service Cost."

One example involved Audit Report No. 1461-2009D101000001, in which DCAA questioned \$565,000 in public relation costs as expressly unallowable and subject to penalties in accordance with FAR 31.205-1(f)(2). During negotiations on the DCAA-questioned costs, the contracting officer received additional information from the contractor to dispute DCAA's questioned costs and recommended penalties. Based on the additional information, the contracting officer allowed \$513,000 of the \$565,000 in public relations costs, and she did not assess any penalties. However, the negotiation memorandum did not address whether the contracting officer had consulted with DCAA on the additional information. In addition, the contracting officer was unable to provide us with a copy of the additional information she relied upon to allow \$513,000 of the questioned costs.

Supervisors Did Not Effectively Oversee the Contracting Officers' Actions

For the 18 audit reports when DMCA contracting officers did not adequately explain why they disagreed with DCAA, DCMA supervisors did not exercise appropriate oversight of the actions taken on the DCAA audit report. Specifically, the supervisors did not:

- ensure that 18 contracting officers documented adequate rationale when they disagreed with the DCAA penalties recommendations;
- require 14 contracting officers to obtain DCMA legal counsel advice when they disagreed with DCAA penalty recommendations, even though the disagreement was clearly based on an interpretation of law or regulation; and
- question why nine contracting officers did not obtain DCAA's opinion on additional information received after the issuance of the audit reports.

In addition, for 8 of 18 audit reports, the DCMA contract files did not contain evidence of any supervisory review or feedback of the contracting officers' actions on DCAA's penalties assessment recommendations, except for signing the negotiation memorandum as the supervisor. DCMA Instruction 125, paragraph 2.2.7, requires supervisors to provide review comments prior to contracting officers' completing their actions. However, the instruction does not require that the review comments be documented in writing. Without evidence of supervisory review, we could not establish the degree to which the supervisor oversaw the contracting officer actions in response to the DCAA audit reports.

In all 18 instances, the contracting officers obtained management signatures on their actions documented in the negotiation memorandum, which included reasons for not assessing penalties and interest, as DCMA Instruction 125,

paragraph 3.6.5, requires. However, the approval by management did not serve as an effective control for ensuring that contracting officers complied with FAR 31.205 and FAR 42.709 requirements.

Supervision is a key control to monitoring contracting officers' actions. Effective supervisory review of the contracting officers' negotiation memorandums could have identified the inadequate rationale and prompted the supervisors to initiate corrective actions. Therefore, DCMA should provide training to supervisors, as well as contracting officers, on the requirements for identifying unallowable costs in FAR 31.205 and for assessing and waiving penalties in FAR 42.709. In addition, DCMA should revise Defense Contract Management Agency procedures to require that supervisors document their review comments on the contracting officers' actions in writing.

Management Actions on Prior Recommendations

In Report No. DODIG-2019-070, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency," March 29, 2019, we reported that DCMA contracting officers did not consult with legal counsel and did not obtain DCAA's opinion on additional information received from contractors after audit report issuance.

In response to Report No. DODIG-2019-070, DCMA stated that it would provide training to contracting officers by September 30, 2019, that covers the requirements for consulting with legal counsel and for obtaining DCAA's opinion on additional information contracting officers receive during negotiations. In addition, DCMA issued a memorandum on March 25, 2019, reminding the contracting officers and contract directors to obtain a legal opinion. Therefore, we are not including a recommendation in this report to address these issues. However, DCMA management should incorporate in the coming training the requirements for maintaining evidence of supervisory involvement other than signing the memorandum.

Conclusion

The contracting officers did not collect penalties on \$43 million in costs that may have been unallowable and subject to penalties in accordance with FAR 42.709-3. The failure of contracting officers to assess and impose penalties, when appropriate, diminishes the incentive of DoD contractors to exclude expressly unallowable costs from incurred cost proposals and increases the risk or likelihood of the DoD paying

for costs that are unallowable under public law. In addition, the Government made payments to the contractors up to \$23 million in costs that may not have complied with the FAR.

DCMA should review the contracting officers' decisions for not assessing penalties on \$43 million of expressly unallowable costs reported by DCAA. If DCMA concludes that any of the costs did not comply with FAR 31.205, DCMA should explore available remedies for recouping the expressly unallowable costs, and obtain payment from the contractor for any penalties due to the government.

Although the contracting officer and DoD contractor signed a binding agreement covering the indirect cost rates, the contracting officer can, at a minimum, request a voluntary reimbursement of any expressly unallowable costs not previously disallowed, and a voluntary payment of penalties for including the costs in the DoD contractor's indirect cost rate proposal.

Recommendations, Management Comments, and Our Response

Recommendation A.1

We recommend that the Defense Contract Management Agency Director:

- a. For the 18 audit reports in which the contracting officers did not document adequate rationale as shown in Appendix B, review the contracting officers' decision to not assess penalties on \$43 million of expressly unallowable costs reported by Defense Contract Audit Agency, to determine whether the costs are expressly unallowable in accordance with Federal Acquisition Regulation 31.205, "Selected Costs," and subject to penalty in accordance with Federal Acquisition Regulation 42.709, "Penalties for Unallowable Costs."**
- b. Based on the results of the review in Recommendation A.1.a, take steps to:**
 - 1. Recoup any expressly unallowable costs not previously disallowed.**
 - 2. Obtain payment from the contractor for any associated penalties due to the Government.**

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that DCMA will, within 6 months, evaluate the 18 audit reports in which the contracting officer did not document adequate rationale. The DCMA Director stated that, if DCMA determines that the contracting officers lacked adequate rationale, DCMA will

seek payment from the contractor and the responsible chain of command will go through the process to attempt to recoup any unallowable costs identified by FAR 31.205 and assess penalties and interest.

Our Response

Comments from the Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved, but will remain open. We will close this recommendation once we verify that DCMA reviewed the 18 subject reports and:

- determined whether the contracting officers lacked adequate rationale for any of the 18 reports;
- attempted to obtain payment from the contractor; and
- attempted, through the responsible chain of command, to recoup any unallowable costs identified by FAR 31.205 and assess penalties and interest.

Recommendation A.2

We recommend that the Defense Contract Management Agency Director provide training to contracting officers and supervisors on the requirements for identifying unallowable costs and for assessing and waiving penalties, including:

- a. Federal Acquisition Regulation 31.205, “Selected Costs.”**
- b. Federal Acquisition Regulation 42.709, “Penalties for Unallowable Costs.”**

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that DCMA will, within 6 months, review its training that addressed FAR 31.205, “Selected Costs” and FAR 42.709, “Penalties for Unallowable Costs” as well as existing guidance provided to the workforce on the two FAR subjects. Additionally, the Director stated that DCMA will review any content on the two FAR areas that are available within the Defense Acquisition University and DCMA courses and will highlight those to the workforce. If, after the training and guidance review is conducted, DCMA determines that additional knowledge-sharing is necessary, it will be take appropriate actions.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved, but will remain open. We will close this recommendation once we verify that DCMA conducted its review of the training and guidance that addressed FAR 31.205, “Selected Costs” and FAR 42.709 and determined if additional knowledge sharing was necessary and obtain a copy of actions taken.

Recommendation A.3

We recommend that the Defense Contract Management Agency Director revise DCMA procedures to require that supervisors document their review comments on the contracting officers' actions in writing.

Defense Contract Management Agency Comments

The DCMA Director partially agreed with the recommendation. The Director stated that DCMA will evaluate and review files during an assessment of existing procedures and add rigor to the supervisory review process, as needed. Additionally, the Director stated that DCMA is taking actions to create a more robust guidance repository for the subject area (associated with the Indirect Cost Control Resource Page) and that the supervisory review procedures are under review. Furthermore, the Director stated that if processes and procedures need to be adopted to ensure adequate reviews are taking place at the individual level, the manual content will be updated.

Our Response

Although the Director partially agreed with the recommendation, the actions planned by the Director satisfy the intent of the recommendation. Therefore, the recommendation is resolved, but will remain open. We will close this recommendation once we verify that DCMA has evaluated the supervisor review process and determined if any processes and procedures needed to be adopted to ensure adequate reviews are taking place, and whether DCMA updated its manual content for the supervisory review process area.

Finding B

DCMA Contracting Officers Incorrectly Calculated Penalties and Interest Due to the Government

For 14 of the 28 DCAA audit reports we selected, the contracting officers appropriately decided to assess penalties against the DoD contractors. However, 7 of the 14 contracting officers did not assess the correct amount of penalties in accordance with FAR 42.709-1(a)(1)(i), which states that the penalty is equal to the amount of the disallowed (unallowable) costs allocated to Government contracts that are subject to penalties.²³

Additionally, of the 14 contracting officers who assessed penalties, 7 did not calculate and collect the correct amount of interest due to the Government, and 1 did not calculate or collect any of the associated interest due to the Government, as FAR 42.709-4 requires.

These deficiencies occurred because DCMA contracting officers were not consistently trained on how to calculate penalties or interest. Of the eight contracting officers who incorrectly calculated penalties or interest, five of them did not receive training on the calculation of penalties or interest. As a result, the contracting officers did not collect the correct amount of penalties and interest due to the Government on expressly unallowable costs claimed by DoD contractors.

Seven Contracting Officers Incorrectly Calculated Penalties Due to the Government

For 14 of the 28 DCAA audit reports we selected, the contracting officers decided to assess penalties against the DoD contractors. However, 7 of the 14 contracting officers incorrectly calculated penalties due to the Government in accordance with FAR 42.709-1(a)(1)(i), which states that the penalty is equal to the amount of the disallowed (unallowable) costs allocated to Government contracts that are subject to penalties.²⁴ In all seven instances, the contracting officers did not correctly calculate the amount of unallowable costs allocated to Government contracts that were subject to penalties.

For example, in response to Audit Report No. 4371-2010C10100001, the contracting officer sustained \$249,000 in DCAA-reported expressly unallowable costs that were claimed among five overhead pools. Rather than calculate the actual amount of

²³ FAR 42.709-1(a)(1)(i), "General."

²⁴ Government contracts that are subject to penalties include flexibly priced contracts currently exceeding \$750,000.

the costs that were allocated to Government contracts from each overhead pool, the contracting officer used an average allocation percentage for all five overhead pools. As a result of using an average, the contracting officer assessed \$85,000 in penalties, but he should have assessed \$101,000. Therefore, the contracting officer did not collect \$16,000 (\$101,000 less \$85,000) in penalties due to the Government.

When we asked the contracting officer why he used an average instead of applying each percentage allocated to Government contracts from each overhead pool, he stated: “Either method would be a reasonable way to assess the final penalty portion of the expressly unallowable costs.” We disagree that the use of an average allocation percentage is reasonable because it does not comply with FAR 42.709-1(a)(1)(i), which requires the use of the actual amount of costs that were allocated to each overhead pool.

Eight Contracting Officers Incorrectly Calculated Interest Due to the Government

Of the 14 contracting officers who assessed penalties, 7 did not calculate and collect the correct amount of interest due to the Government, and 1 did not calculate or collect any of the interest due to the Government, as FAR 42.709-4 requires. FAR 42.709-4 requires that contracting officers assess interest on any paid portion of the disallowed (unallowable) costs from the midpoint of the contractor’s fiscal year to the date of the Government’s demand for payment of the penalties. In addition, FAR clause 52.242-3(d)(2) requires that contracting officers use the semiannual interest rates prescribed by the Secretary of the Treasury to calculate the interest.²⁵

Of the seven contracting officers who did not calculate and collect the correct interest, six used the wrong date for the midpoint of the contractor’s fiscal year or the wrong date for the Government’s demand for payment.²⁶ For example, for DCAA Audit Report No. 3221-2010T10100001, the contracting officer computed the interest due to the Government starting on July 1, 2011, instead of July 1, 2010, which was the correct midpoint of the contractor’s fiscal year. As a result, the contracting officer understated the interest due to the Government by \$20,000.

One of the seven contracting officers incorrectly used the quarterly interest rates published by the Secretary of the Treasury instead of the semiannual simple interest rates prescribed by the FAR. As a result, the contracting officer understated the interest due to the Government by \$168.

²⁵ FAR Clause 52.242-3(d)(2), “Penalties for Unallowable Costs.”

²⁶ A demand for payment is the Government’s formal written request for payment of a contractor’s debt, including penalties and interest.

Contracting Officers Did Not Receive Training on the Calculation of Penalties and Interest

We identified the lack of training as a factor that contributed to contracting officers not correctly calculating penalties and interest. Of the eight contracting officers who incorrectly calculated penalties or interest, five of them did not receive training covering the FAR requirements for calculating penalties or interest. Therefore, DCMA should provide training to contracting officers on the requirements in FAR 42.709, "Penalties for Unallowable Costs," to help ensure that contracting officers accurately calculate penalties and interest due to the Government.

Conclusion

For 7 of the 14 audit reports, the contracting officers did not correctly calculate penalties on expressly unallowable costs in accordance with FAR 42.709-1(a)(1)(i). In addition, for 8 of the 14 audit reports, the contracting officers did not correctly calculate or collect the interest due to the Government in accordance with FAR 42.709-4 and FAR clause 52.242-3(d)(2). We determined that a lack of training contributed to contracting officers not correctly calculating penalties and interest. As a result, the contracting officers did not collect the appropriate penalties and interest due to the Government on expressly unallowable costs claimed by DoD contractors.

DCMA should review the contracting officers' penalty and interest calculations for compliance with FAR 42.709-1, "General," and FAR 42.709-4, "Computing Interest." If DCMA concludes that the penalty and interest amounts were incorrectly calculated, DCMA should explore available remedies for recovering any amounts due to the Government from the DoD contractor. Although the contracting officer and DoD contractor signed a binding agreement covering the indirect cost rates, the contracting officer can, at a minimum, request a voluntary payment for the difference between the penalties and interest that should have been collected and the amounts that were previously collected from the DoD contractor.

Recommendations, Management Comments, and Our Response

Recommendation B.1

We recommend that the Defense Contract Management Agency Director:

- a. For the audit reports for which the contracting officers did not correctly calculate penalties and interest as shown in Appendix D, review the contracting officers' calculation of penalty and interest due to the Government to determine the penalties and interest that should have been collected in accordance with Federal Acquisition Regulation 42.709 1, "General," and 42.709-4, "Computing Interest."
- b. Based on the results of the review in Recommendation B.1.a, take steps to recoup the difference between the penalties and interest that should have been collected in accordance with the Federal Acquisition Regulation and the amounts that were previously collected.

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that DCMA will, within 6 months, evaluate the eight instances in which DCMA contracting officers incorrectly calculated penalties and interest. The DCMA Director stated that if DCMA determines the contracting officers incorrectly calculated penalties and interest, the responsible chain of command will attempt to recoup any expressly unallowable costs not previously disallowed and any associated penalties and interest.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved, but will remain open. We will close this recommendation once we verify that DCMA evaluated the eight instances in which the DCMA contracting officers incorrectly calculated penalties and:

- determined the penalties and interest that should have been collected; and
- attempted, through the responsible chain of command, to recoup any expressly unallowable costs not previously disallowed, along with any associated penalties and interest.

Recommendation B.2

We recommend that the Defense Contract Management Agency Director provide training to contracting officers in the following areas:

- 1. Calculating penalties in accordance with Federal Acquisition Regulation 42.709-1(a)(1)(i), “General.”**
- 2. Computing interest in accordance with Federal Acquisition Regulation 42.709-4, “Computing Interest.”**

Defense Contract Management Agency Comments

The DCMA Director partially agreed with the recommendation and stated that DCMA will, within 6 months, review all existing training material providing specific coverage in the area of FAR 42.709-1(a)(1)(i), “General” and FAR 42.709-4, “Computing Interest.” The Director also stated that if DCMA determines that additional training is warranted, DCMA will fully support this recommendation and conduct follow-on training on the two FAR areas. Additionally, DCMA will post any training it provides on calculating penalties and interest associated with expressly unallowable costs to its repository website.

Our Response

Although the Director partially agreed with the recommendation, the actions planned by the Director satisfy the intent of the recommendation. Therefore, the recommendation is resolved, but will remain open. We will close this recommendation once we verify that DCMA has evaluated its training material; conducted training on FAR 42.709-1(a)(1)(i), “General” and FAR 42.709-4, “Computing Interest;” and posted the training to its repository website.

Appendix A

Scope and Methodology

We conducted this evaluation from May 2018 through August 2019 in accordance with the “Quality Standards for Inspections and Evaluations” published in December 2016 by the Council of the Inspectors General on Integrity and Efficiency. Those standards require that we adequately plan the evaluation to ensure that objectives are met and that we perform the evaluation to obtain sufficient, competent, and relevant evidence to support the findings, conclusion, and recommendations. We believe that the evidence obtained was sufficient, competent, and relevant to lead a reasonable person to sustain the findings, conclusions, and recommendations.

To accomplish our evaluation objective, we:

- reviewed parts of the FAR, DoD Instructions, and DCMA procedures addressing penalties on expressly unallowable costs;
- selected a non-statistical sample of 28 DCAA audit reports issued, which collectively questioned \$154 million of expressly unallowable cost subject to penalty and addressed by contracting officers between April 1, 2016, and March 30, 2018;
- gained an understanding of the DCAA-questioned costs and associated support;
- interviewed DCAA audit staff to clarify our understanding of the DCAA-questioned costs subject to penalty;
- gathered and analyzed DCMA records of contracting officers’ actions taken on the DCAA-questioned costs subject to penalty;
- interviewed DCMA contracting officials involved in taking action on the questioned costs subject to penalty; and
- evaluated DCMA contracting officer actions for compliance with the FAR, DoD Instruction 7640.02, and DCMA Instructions.

To select the non-statistical sample, we obtained a universe of 358 DCAA audit reports from DCAA headquarters representatives which collectively questioned \$320 million of costs subject to penalty and addressed by contracting officers from April 1, 2016, to March 30, 2018. The universe was generated from DCAA’s management information system. We selected the 28 reports that contained significant amounts of questioned costs subject to penalties. The questioned cost within the 28 reports total \$154 million, 48 percent of the questioned cost universe of \$320 million.

Use of Computer-Processed Data

In selecting the 28 DCAA audit reports, we obtained a computerized list of audit reports addressed by contracting officers between April 1, 2016, and March 30, 2018. DCAA generated the list from its management information system. We tested the reliability of the list of DCAA reports by tracing the 28 selected reports to source documents and determined that the data in the list was reliable.

Use of Technical Assistance

We did not rely on technical assistance for this evaluation.

Prior Coverage

During the last 5 years, the DoD OIG issued six reports on the actions that DCMA contracting officers took in response to DCAA audit reports. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/reports.html/>.

DoD OIG

Report No. DODIG-2019-070, “Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency,” March 29, 2019

The DoD OIG evaluated contracting officer actions on DoD contractor executive compensation questioned by DCAA to determine whether the actions taken by DCMA contracting officers’ actions complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy.

Report No. DODIG-2018-134, “Evaluation of DoD Hotline Complaint Regarding Defense Contract Management Agency Baltimore’s Actions on Audit Findings Reported by Defense Contract Audit Agency,” July 9, 2018

The DoD OIG evaluated a Defense Hotline complaint alleging that a DCMA contracting officer at the Baltimore field office did not take appropriate action on a DCAA audit report which identified \$1.1 million in indirect costs that did not comply with the FAR.

Report No. DODIG-2017-055, “Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports,” February 9, 2017

The DoD OIG evaluated the appropriateness of DCMA actions on DCAA findings reported in 22 incurred cost audit reports.

Report No. DODIG-2017-032, "Evaluation of Contracting Officer Actions on Cost Accounting Standard Noncompliances Reported by Defense Contract Audit Agency," December 8, 2016

The DoD OIG evaluated contracting officer actions on cost accounting standard noncompliances reported in 27 DCAA audit reports to determine whether the actions complied with FAR 30.6, "Cost Accounting Standards Administration," DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," and DCMA instructions.

Report No. DODIG 2016-001, "Evaluation of Defense Contract Management Agency Actions on Reported DoD Contractor Business System Deficiencies," October 1, 2015

The DoD OIG evaluated DCMA contracting officer actions on DoD contractor business system deficiencies reported in 21 DCAA audit reports.

Report No. DODIG-2015-139, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Reported DoD Contractor Estimating System Deficiencies," June 29, 2015

The DoD OIG evaluated whether DCMA contracting officers took timely and effective actions on 18 DoD contractor estimating system deficiencies reported by DCAA.

Report No. DODIG-2014-084, "Hotline Allegation Regarding Defense Contracting Officer Actions on Several Business System Audit Reports," June 20, 2014

The DoD OIG evaluated the validity of a DoD Hotline complaint alleging that a DCMA contracting officer did not take timely or appropriate action on several DCAA audit reports involving the business systems of a large DoD contractor.

Appendix B

This appendix identifies the 28 DCAA audit reports in which contracting officers did not adequately explain why they disagreed with DCAA on the assessment of penalties or why they waived penalties.

Table 3. Instances in Which Contracting Officers Did Not Adequately Explain Why They Disagreed with DCAA on Assessing Penalties or Why They Waived Penalties

Count	DCAA Audit Report Number	Inadequate Explanation for Disagreeing With DCAA on Penalties	Inadequate Explanation for Waiving Penalties
1	1151-2010W10100001	X	
2	1461-2009D10100001	X	X
3	2151-2009W10100001	X	
4	2631-2009M10100001	X	
5	2701-2007R10100001	X	
6	2801-2010G10100001	X	
7	2801-2011B10100001		
8	2811-2011E10100002		
9	3121-2012K10100001 3181-2010d10100	X	X
10	3181-2010D10100001		
11	3221-2009I10100001		
12	3221-2010T10100001	X	
13	3321-2009K10100002	X	
14	3521-2011U10100001		
15	3711-2009A10100001	X	
16	4141-2010D10100001		
17	4371-2010C10100001	X	
18	4411-2007W10100001		
19	4571-2009A10100002		
20	4571-2011A10100003	X	
21	6211-2006C10100006	X	
22	6211-2007C10100001	X	
23	6501-2008C01010001 S1	X	X
24	6501-2011C10100001	X	
25	6631-2012C10100003	X	X

Table 3. Instances in Which Contracting Officers Did Not Adequately Explain Why They Disagreed with DCAA on Assessing Penalties or Why They Waived Penalties (cont'd)

Count	DCAA Audit Report Number	Inadequate Explanation for Disagreeing With DCAA on Penalties	Inadequate Explanation for Waiving Penalties
26	4621-2010Y10100001	X	
27	2651-2010A10100001		
28	1451-2011M10100001		
Total		18	4

Source: DoD OIG, based on DCMA data.

Appendix C

This appendix identifies factors that contributed to contracting officers not documenting adequate explanations for disagreeing with DCAA penalty recommendations.

Table 4. Contributing Factors for Not Documenting Adequate Explanations

Count	DCAA Audit Report *	Lack of Training	No Legal Review	No DCAA Opinion on Additional Information	Ineffective Supervision
1	1151-2010W10100001				
2	1461-2009D10100001	X	X	X	X
3	2151-2009W10100001				
4	2631-2009M10100001	X	X		
5	2701-2007R10100001	X	X	X	
6	2801-2010G10100001		X	X	
7	3121-2012K10100001 3181-2010d10100	X			X
8	3221-2010T10100001	X	X		
9	3321-2009K10100002	X		X	
10	3711-2009A10100001	X	X	X	X
11	4371-2010C10100001	X	X		
12	4571-2011A10100003	X	X		
13	6211-2006C10100006		X	X	X
14	6211-2007C10100001		X	X	X
15	6501-2008C01010001 S1	X	X	X	X
16	6501-2011C10100001	X	X	X	X
17	6631-2012C10100003	X	X		X
18	4621-2010Y10100001		X		
Total		12	14	9	8

Source: DoD OIG, based on DCMA data.

*Lists only the 18 DCAA audit reports when contracting officers documented inadequate rationale for disagreeing with DCAA.

Appendix D

This appendix identifies DCAA audit reports in which contracting officers incorrectly calculated penalties and interest due to the Government.

Table 5. Incorrect Calculation of Penalties and Interest

Count	DCAA Audit Report	Incorrect	Calculation of Penalties	Incorrect Calculation of Interest
1	1151-2010W10100001			
2	1461-2009D10100001	X	X	
3	2151-2009W10100001			
4	2631-2009M10100001			
5	2701-2007R10100001	X	X	
6	2801-2010G10100001			
7	2801-2011B10100001		X	
8	2811-2011E10100002	X		
9	3121-2012K10100001 3181-2010d10100			
10	3181-2010D10100001			
11	3221-2009I10100001	X	X	
12	3221-2010T10100001	X	X	
13	3321-2009K10100002			
14	3521-2011U10100001			
15	3711-2009A10100001			
16	4141-2010D10100001		X	
17	4371-2010C10100001	X	X	
18	4411-2007W10100001			
19	4571-2009A10100002			
20	4571-2011A10100003			
21	6211-2006C10100006			
22	6211-2007C10100001			
23	6501-2008C01010001 S1			
24	6501-2011C10100001	X	X	
25	6631-2012C10100003			

Table 5. Incorrect Calculation of Penalties and Interest (cont'd)

Count	DCAA Audit Report	Incorrect	Calculation of Penalties	Incorrect Calculation of Interest
26	4621-2010Y10100001			
27	2651-2010A10100001			
28	1451-2011M10100001			
Total		7	8	

Source: DoD OIG, based on DCMA data.

Management Comments

Defense Contract Management Agency Director



DEFENSE CONTRACT MANAGEMENT AGENCY

3901 A. AVENUE, BUILDING 10500
FORT LEE, VIRGINIA 23801-1809

DEC 06 2019

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: DCMA Response to DoDIG Draft Report "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency," November 08, 2019 (Project No. D2018-DAPOCF-0160.000)

Attached is the Defense Contract Management Agency's response to the subject DoDIG Draft Report dated November 08, 2019. Responses address DCMA's concurrence with the recommendations and actions that will be implemented to address recommendation A.1, A.2, A.3, B.1, and B.2 of subject report.




David H. Lewis
VADM, USN
Director

Attachment(s):
TAB A. DoDIG Document with DCMA's Response

Link(s):
None

Defense Contract Management Agency Director (cont'd)

DCMA Response to DoDIG, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency," November 08, 2019 (Project No. D2018-DAPOCF-0160.000)

Recommendation A.1

We recommend that the Defense Contract Management Agency Director:

- a. **For the 18 audit reports in which the contracting officers did not document adequate rationale as shown in Appendix B, review the contracting officers' decision to not assess penalties on \$43 million of expressly unallowable costs reported by DCAA, to determine whether the costs are expressly unallowable in accordance with Federal Acquisition Regulation 31.205, "Selected Costs," and subject to penalty in accordance with Federal Acquisition Regulation 42.709, "Penalties for Unallowable Costs."**
- b. **Based on the results of the review in Recommendation A.1.a, take steps to:**
 1. **Recoup any expressly unallowable costs not previously disallowed.**
 2. **Obtain payment from the contractor for any associated penalties due to the Government.**

DCMA Response:

DCMA concurs with this recommendation and will evaluate the 18 audit reports within six months in which DoDIG noted that the contracting officers did not document adequate rationale as shown in Appendix B. If DCMA determines the contracting officers lacked adequate rationale and that payment should be sought from the contractor, the responsible chain of command will go through the process to attempt to recoup any unallowable costs identified by FAR 31.205, and assessing penalties and interest.

Recommendation A.2

We recommend that the Defense Contract Management Agency Director provide training to contracting officers and supervisors on the requirements for identifying unallowable costs and for assessing and waiving penalties, including:

- a. **Federal Acquisition Regulation 31.205, "Selected Costs."**
- b. **Federal Acquisition Regulation 42.709, "Penalties for Unallowable Costs."**

Defense Contract Management Agency Director (cont'd)

DCMA Response to DoDIG, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency," November 08, 2019 (Project No. D2018-DAPOCF-0160.000)

DCMA Response:

DCMA concurs with this recommendation. DCMA will review training within six months that was conducted to address Federal Acquisition Regulation 31.205, "Selected Costs", Federal Acquisition Regulation 42.709, "Penalties for Unallowable Costs", and existing guidance provided to the workforce on this subject. Additionally, any content or coverage on this subject area found in Defense Acquisition University (DAU) and/or DCMA courses will be highlighted to the workforce. After a complete training and guidance assessment is conducted, if DCMA determines that additional knowledge-sharing is necessary, actions will be taken as appropriate.

Recommendation A.3

We recommend that the Defense Contract Management Agency Director revise DCMA procedures to require that supervisors document their review comments on the contracting officers' actions in writing.

DCMA Response:

DCMA partially concurs with this recommendation. DCMA will evaluate and review files during an assessment of existing procedures and add rigor to the supervisory review process as needed. DCMA is taking actions to create a more robust guidance repository for this subject area (associated with the Indirect Cost Control Resource Page) and the supervisory review procedures are under evaluation. Therefore, if processes and procedures need to be adopted in order to ensure adequate reviews are taking place at the individual level, manual content will be updated.

Recommendation B.1

We recommend that the Defense Contract Management Agency Director:

- a. For the audit reports for which the contracting officers did not correctly calculate penalties and interest as shown in Appendix D, review the contracting officers' calculation of penalty and interest due to the Government, to determine the penalties and interest that should have been collected in accordance with Federal Acquisition Regulation 42.709 1, "General," and 42.709-4, "Computing Interest."**
- b. Based on the results of the review in Recommendation B.1.a, take steps to recoup the difference between the penalties and interest that should have been collected in accordance with the Federal Acquisition Regulation and the amounts that were previously collected.**

Defense Contract Management Agency Director (cont'd)

DCMA Response to DoDIG, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Penalties Recommended by the Defense Contract Audit Agency," November 08, 2019 (Project No. D2018-DAPOCF-0160.000)

DCMA Response:

DCMA concurs with this recommendation and will evaluate the audits where DoDIG identified the contracting officers of not correctly calculate penalties and interest as shown in Appendix D within six months. If DCMA determines the contracting officers incorrectly calculated penalties and interest, the responsible chain of command will be informed of the requirement to go through the process of attempting to recoup any expressly unallowable costs not previously disallowed, as well as any associated penalties and interest.

Recommendation B.2

We recommend that the Defense Contract Management Agency Director provide training to contracting officers in the following areas:

- a. **Calculating penalties in accordance with Federal Acquisition Regulation 42.709-1(a)(1)(i), "General."**
- b. **Computing interest in accordance with Federal Acquisition Regulation 42.709-4, "Computing Interest."**

DCMA Response:

DCMA partially concurs with this recommendation. Within six months; we will review all existing training material providing specific coverage in this area. If DCMA determines that additional training is warranted, DCMA will fully support these recommendations and conduct follow-on training as necessary on Federal Acquisition Regulation 42.709-1 (a)(1)(i), "General" and Federal Acquisition Regulation 42.709-4, "Computing Interest." In addition to existing DAU and DCMA courses that provide related coverage, DCMA-AQC maintains a training resource repository on DCMA 360 where available training is posted by subject area for ease of access by DCMA contracting personnel. DCMA will post any training it provides on calculating penalties and interest associated with expressly unallowable costs to this repository website.

Acronyms and Abbreviations

- DCAA** Defense Contract Audit Agency
- DCMA** Defense Contract Management Agency
- FAR** Federal Acquisition Regulation
- DFARS** Defense Federal Acquisition Regulation Supplement



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