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INSPECTOR GENERAL

U.S. Department of Defense

FEBRUARY 26, 2021



(U) Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors

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(U) Results in Brief

(U) Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors

February 26, 2021

(U) Objective

(U) The objective of this evaluation was to determine whether the actions taken by Defense Contract Management Agency (DCMA) contracting officers on Defense Contract Audit Agency (DCAA) audit report findings complied with applicable Federal Acquisition Regulation (FAR), DoD Instruction 7640.02, and DCMA policy.¹ Our evaluation focused on DCMA contracting officer actions on DCAA audit reports related to two of the largest DoD contractors. The contractor names are not disclosed because this evaluation addresses contracting officer actions on the DCAA audit report findings and recommendations that are pre-decisional in nature and subject to negotiation and settlement. Therefore, this report refers to the two DoD contractors as Contractor A and Contractor B.

(U) Background

(U) According to FAR 42.302, the contract administration office is responsible for several administrative functions, including determining:

- (U) allowability of incurred costs;
- (U) compliance with the 19 Cost Accounting Standards (CAS) on applicable contracts; and
- (U) compliance with business system requirements.²

¹ (U) DoD Instruction 7640.02, "Policy for Follow Up on Contract Audit Reports," April 15, 2015.

² (U) FAR 42.302, "Contract administration functions."

(U) Background (cont'd)

(U) In most instances, the DCMA is designated as the contract administration office for DoD contracts. DoD Instruction 7640.02 requires that contracting officers take timely and appropriate actions in response to findings and recommendations in DCAA audit reports. Contracting officers are required to complete their actions on a DCAA audit report ("settle" a DCAA audit report) within 12 months. As part of settling a DCAA audit report, the FAR and DCMA policy require that contracting officers prepare a negotiation memorandum that includes sound rationale for not upholding any of the DCAA findings and recommendations.

(U) Finding

(U) For 14 of the 30 DCAA audit reports we evaluated, we determined that DCMA contracting officers did not comply with the FAR when they settled DCAA audit reports associated with two of the largest DoD contractors. Specifically, DCMA contracting officers did not:

- (U) adequately document or explain why they disagreed with \$97 million in questioned costs from eight DCAA incurred cost audit reports; or
- (U) issue a notice of potential noncompliance within 15 days on DCAA reported CAS noncompliances, make a determination of CAS compliance or noncompliance, or determine the cost impact to the Government from six DCAA CAS audit reports.

(U) As a result, DCMA contracting officer actions on the eight audit reports may have resulted in improperly reimbursing DoD contractors up to \$97 million in unallowable costs on Government contracts. In addition, because DCMA contracting officers did not take timely action on six audit reports, they delayed the correction of CAS noncompliances and the recovery of any increased costs due to the Government.



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(U) Results in Brief

(U) Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors

(U) Recommendations

(U) Among our five recommendations, we recommend that the Defense Contract Management Agency Director:

- (U) Review the contracting officers' decision to not uphold the \$97 million of questioned costs in the eight DCAA incurred cost audit reports, determine whether the costs are unallowable in accordance with the FAR, and take steps to settle all findings, as necessary.
- (U) Remind all DCMA contracting officers in writing of the requirement to issue a notice of potential CAS noncompliance within 15 days of receipt of a reported CAS noncompliance, in accordance with the FAR.
- (U) Require the supervisors of the contracting officers for the 14 audit reports to receive training on the level of review necessary to ensure that contracting officers complete actions appropriately when they address DCAA audit reports.

(U) Management Comments and Our Response

(U) The Defense Contract Management Agency Director agreed with all five recommendations. The Director's planned actions include:

- (U) reviewing contracting officer decisions to not uphold the \$97 million of questioned costs in the eight DCAA incurred cost audit reports,
- (U) reminding all DCMA contracting officers of the requirement to issue a notice of potential CAS noncompliance within 15 days, and
- (U) providing training to the DCMA supervisors assigned to the 14 audit reports.

(U) We determined that the Director's comments and planned actions addressed the specifics of all five recommendations. Therefore, the five recommendations are resolved, but will remain open until we verify that the DCMA has completed the planned actions.

(U) Please see the Recommendations Table on the next page for the status of the recommendations.

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(U) Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
(U) Defense Contract Management Agency Director	None	1, 2, 3, 4, 5	None

(U) Note: The following categories are used to describe agency management's comments to individual recommendations.

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





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

February 26, 2021

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

SUBJECT: (U) Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors (Report No. DODIG-2021-056)

(U) 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 management comments on the recommendations. We considered management's comments in finalizing the report and included them in the report.

(U) The Defense Contract Management Agency Director plans to take action in response to the recommendations presented in the report; therefore, we consider the recommendations resolved and open. As described in the Recommendations, Management Comments, and Our Response section of this report, we will close the recommendations when you provide us documentation showing that all agreed-upon actions to implement the recommendations are completed. Therefore, please provide us within 90 days your response concerning specific actions in process or completed on the recommendations. Send your response to followup@dodig.mil.

(U) If you have any questions, please contact [REDACTED]
[REDACTED]

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

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

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(U) Introduction

(U) Objective

(U) The objective of this evaluation was to determine whether the actions taken by Defense Contract Management Agency (DCMA) contracting officers on Defense Contract Audit Agency (DCAA) audit report findings complied with applicable Federal Acquisition Regulation (FAR), DoD Instruction 7640.02, and DCMA policy. We focused our evaluation on DCMA contracting officer actions on 30 DCAA audit reports issued from April 2015 through February 2018 for two of the largest DoD contractors. The contractor names are not disclosed because this evaluation addresses contracting officer actions on the DCAA findings and recommendations that are pre-decisional in nature and subject to negotiation and settlement. Therefore, this report refers to the two DoD contractors as Contractor A and Contractor B. Appendix A contains the details of our scope and methodology.

(U) Background

(U) The FAR and the Defense Federal Acquisition Regulation Supplement (DFARS) are the primary regulations that DCMA contracting officers follow to acquire supplies and services. The DFARS implements and supplements the FAR for acquiring goods and services in the DoD. According to FAR 42.302, the contract administration office is responsible for several contract administrative functions, including determining:

- (U) allowability of incurred costs (FAR subpart 42.7);
- (U) compliance with the 19 Cost Accounting Standards (CAS) on applicable contracts (FAR subpart 30.6); and
- (U) compliance with business system requirements (DFARS subpart 242.70).³

(U) In most instances, the DCMA is designated as the contract administration office for DoD contracts.

³ (U) FAR 42.302, "Contract Administration Functions;" FAR Subpart 42.7, "Indirect Cost Rates;" FAR Subpart 30.6, "CAS Administration;" and DFARS Subpart 242.70, "Contractor Business Systems."

(U) Defense Contract Audit Agency Performs Audits of DoD Contractors

(U) The DCAA performs audits of DoD contractors for the DoD in accordance with DoD Directive 5105.36 and reports to the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD.⁴ The DCAA performs several types of audits of DoD contractors, including the following:

- **(U) Incurred Cost Audit.** This type of audit identifies a DoD contractor's annual incurred costs claimed on Government contracts that are potentially unallowable based on applicable criteria in the FAR, the DFARS, CAS, and contract terms.
- **(U) CAS Audit.** This type of audit reports on a DoD contractor's potential noncompliances with CAS that an auditor has observed.⁵
- **(U) Business System Deficiency Audit.** This type of audit identifies a DoD contractor's potential deficiencies with one of its business systems based on DFARS subpart 242.70.

(U) The DCAA organizational structure consists of a headquarters, three regions, a Field Detachment for conducting classified audits, and four Corporate Audit Directorates for conducting audits at seven of the DoD's largest contractors. The DCAA established the Corporate Audit Directorates to improve communications among multiple field audit offices assigned to one of the seven contractors, create consistent audit approaches, and eliminate audit duplication.

(U) DoD Instruction 7640.02 Includes Reporting Requirements and Follow-up Procedures for DCAA Audit Reports

(U) DoD Instruction 7640.02 establishes policy, assigns responsibilities, and includes reporting requirements and follow-up procedures for DCAA audit reports, including incurred cost audit reports, CAS audit reports, and business system deficiency audit reports.⁶ The Instruction requires contracting officers to take timely and appropriate actions in response to findings and recommendations in DCAA audit reports.

⁴ (U) DoD Directive 5105.36, "Defense Contract Audit Agency," January 4, 2010.

⁵ (U) CAS are identified in Title 48 Code of Federal Regulation section 9904, "Cost Accounting Standards," April 17, 1992.

⁶ (U) DoD Instruction 7640.02, "Policy for Follow Up on Contract Audit Reports," April 15, 2015.

(U) According to the Instruction, DCMA contracting officers are required to complete their actions on a DCAA audit report (hereafter referred to as “settle” a DCAA audit report) within 12 months. The DCAA audit report is considered settled when a contracting officer has prepared a negotiation memorandum and one of the following actions occurs.⁷

- (U) The contracting officer negotiates a settlement of the annual incurred costs claimed on Government contracts with the contractor and executes any required contracting action.
- (U) The contracting officer issues a final determination on a CAS audit.
- (U) The contracting officer notifies the contractor in writing of the final determination covering business systems findings and recommendations.

(U) In addition, DoD Instruction 7640.02 requires the contracting officer to indicate whether the contracting officer agrees with each DCAA finding or recommendation and, if not, to document the rationale for the disagreement in the negotiation memorandum.

(U) DoD Instruction 7640.02 also establishes recordkeeping and reporting requirements for reportable contract audit reports.⁸ In support of the recordkeeping requirements, the DCMA maintains an automated database referred to as the Contract Audit Follow-Up (CAFU) system that DoD Components use to track and record actions taken to settle contract audit reports. The CAFU system creates a record for each DCAA audit report.⁹ Contracting officers must address all audit report findings and recommendations and prepare a negotiation memorandum before reporting the audit as settled in the CAFU system.

(U) DCMA Is Responsible for Taking Action on Most DCAA Audit Reports

(U) As the designated contract administration office, the DCMA is responsible for taking action on most DCAA audit reports. In accordance with DoD Directive 5105.64, the DCMA reports to the Under Secretary of Defense for Acquisition and Sustainment.¹⁰ The DCMA works directly with DoD contractors to ensure that Government supplies and services are delivered on time and at the projected cost.

⁷ (U) The negotiation memorandum provides a written record of the contracting officer’s decision on the DCAA audit report and includes rationale for not upholding any of the DCAA reported findings and recommendations.

⁸ (U) With limited exceptions, DoD Instruction 7640.02 defines reportable contract audit reports as all contract audit reports that include questioned costs or recommendations and that require contracting officer action.

⁹ (U) The DCAA may issue a “multi-year” audit report that includes more than one unique DCAA audit report number. In these instances, we counted each DCAA audit report number as a separate CAFU record.

¹⁰ (U) DoD Directive 5105.64, “Defense Contract Management Agency,” January 10, 2013.

(U) The DCMA organizational structure consists of a headquarters, three regions, a Special Program Command, an International Command, and the Cost and Pricing Regional Command. As of January 23, 2020, the DCMA was administering 308,000 contracts, involving 15,000 contractor locations worldwide. The Cost and Pricing Regional Command includes the Corporate and Divisional Administrative Contracting Officer Division, which administers contracts associated with 40 of the largest DoD contractors.

(U) Within the Corporate and Divisional Administrative Contracting Officer Division, the DCMA divides contract administration responsibilities between two types of contracting officers. Divisional administrative contracting officers (DACOs) are responsible for one or more divisions of a large DoD contractor.¹¹ The DACOs report to the corporate administrative contracting officer (CACO), who has overall responsibility for all divisions of a DoD contractor. The DCMA created CACO and DACO teams for major contractors to improve the DCMA's ability to provide consistent oversight of a contractor, particularly in the areas of incurred costs, CAS, business systems, and forward pricing. The CACO and DACO teams are responsible for promoting effectiveness and consistency in the performance of contract administration services. This evaluation focused on the CACO and DACO teams responsible for two of the largest DoD contractors. When we address the CACO and DACO collectively for a single contractor, this report refers to the CACO and DACO as the DCMA contracting officers.

(U) The DCMA developed the following instructions that implement key parts of the FAR and DoD Instruction 7640.02 for contracting officer actions on DCAA audit reports.

- (U) DCMA Instruction 108 provides procedures for the administration of the CAS, including how to process CAS noncompliances and how to resolve the cost impact of a noncompliance.¹²
- (U) DCMA Instruction 125 requires the contracting officer to evaluate all DCAA findings, appropriately settle final indirect rates, and document the results in a negotiation memorandum. The instruction also requires the contracting officer to retain documents associated with the settlement of the final indirect cost rate proposal.¹³

¹¹ (U) Large DoD contractors can consist of a parent company and smaller operating divisions.

¹² (U) DCMA Instruction 108, "Cost Accounting Standards Administration," April 3, 2013. On February 7, 2019, DCMA Manual 2201-02, "Cost Accounting Standards Administration," replaced DCMA Instruction 108.

¹³ (U) DCMA Instruction 125, "Indirect Rates," April 21, 2014. On February 14, 2019, DCMA Manual 2201-03, "Final Indirect Cost Rates," replaced DCMA Instruction 125.

- (U) DCMA Instruction 126 reiterates the requirements of DoD Instruction 7640.02 for taking action on all DCAA findings and recommendations and emphasizes that contracting officers must include sound rationale in the negotiation memorandum when they disagree with audit findings and recommendations.¹⁴
- (U) DCMA Instruction 131 requires the contracting officer to determine the acceptability of the contractor's business system in accordance with DFARS business system criteria and approve or disapprove the contractor's business system.¹⁵

(U) We Reviewed 30 DCAA Audit Reports That Identified Findings and Recommendations for Two of the Largest DoD Contractors

(U) We non-statistically selected a sample of 30 DCAA audit reports to review from a universe of 222 audit reports that identified findings and recommendations for Contractors A and B, and were settled by DCMA contracting officers between April 2016 and March 2019. In non-statistically selecting the 30 audit reports, we chose a reasonable cross-section of the types of audit reports that were settled between April 2016 and March 2019. The 30 selected audit reports consisted of the following three types of DCAA audits.

- (U) Eighteen incurred cost audit reports that identified a total of \$1.03 billion in questioned costs. Of the 18 reports, 8 addressed Contractor A and 10 addressed Contractor B.
- (U) Eight CAS audit reports. Of the eight reports, six addressed Contractor A and two addressed Contractor B.
- (U) Four business system deficiency audit reports. Of the four reports, one addressed Contractor A and three addressed Contractor B.

(U) The DCAA issued the 30 audit reports to the DCMA contracting officers for action from April 2015 through February 2018, and the DCMA contracting officers settled the 30 audit reports from October 2016 through September 2018. Of the 30 DCAA audit reports we reviewed, 15 reports addressed Contractor A and 15 reports addressed Contractor B.

(U) Appendix A contains additional details of our scope and methodology. Appendix B lists the 30 DCAA audit reports we selected for our evaluation.

¹⁴ (U) DCMA Instruction 126, "Contract Audit Follow Up," February 11, 2016. On March 3, 2019, DCMA Manual 2201-04, "Contract Audit Follow-up," replaced DCMA Instruction 126.

¹⁵ (U) DCMA Instruction 131, "Contractor Business Systems," December 1, 2015. On April 28, 2019, DCMA Manual 2301-01, "Contractor Business Systems," replaced DCMA Instruction 131.

(U) Finding

(U) DCMA Contracting Officers Did Not Comply With the Federal Acquisition Regulation When They Settled 14 of 30 DCAA Audit Reports

(U) For 14 of the 30 DCAA audit reports we reviewed, DCMA contracting officers did not comply with the FAR when they settled DCAA audit reports associated with two of the largest DoD contractors. Specifically, DCMA contracting officers did not:

- (U) adequately document or explain why they disagreed with \$97 million in questioned costs from eight DCAA incurred cost audit reports, as required by FAR subpart 42.7; or
- (U) comply with FAR 30.605 when they addressed six DCAA CAS audit reports.¹⁶

(U) For the remaining 16 of 30 DCAA audit reports we reviewed, DCMA contracting officers complied with the FAR, DoD Instruction 7640.02, and DCMA policy when they settled the \$369 million in questioned costs, CAS noncompliances, and business system deficiencies reported by the DCAA. We determined that an effective working relationship with the DCAA, fostered by DCMA organizational changes to focus on the 40 largest DoD contractors, and the DCMA's performance of peer reviews, contributed to DCMA contracting officers taking appropriate actions on the 16 reports.¹⁷

(U) We identified the following three factors that contributed to DCMA contracting officers' noncompliance with the FAR when they settled the 14 DCAA audit reports.

- (U) DCMA contracting officers did not obtain a required legal review.
- (U) DCMA supervisors did not provide effective oversight of DCMA contracting officer actions to settle the DCAA audit reports.
- (U) DCMA contracting officers did not maintain detailed contract file documentation, such as documents provided by the contractor during negotiation to support not upholding DCAA audit report findings and recommendations.

¹⁶ (U) FAR 30.605, "Processing noncompliances."

¹⁷ (U) The objective of the DCMA peer review is to ensure that negotiation documents, including the negotiation memorandum, appropriately apply FAR, CAS, and DCMA agency policy prior to the negotiation documents being issued. A peer review team may include other contracting officers, team supervisors, team leads, DCMA legal counsel, and others who were not involved in settling the DCAA questioned costs.

(U) As a result, DCMA contracting officer actions on the 14 DCAA audit reports may have resulted in improperly reimbursing DoD contractors up to \$97 million in costs that may be unallowable on Government contracts. In addition, because the DCMA contracting officers did not take timely action, they delayed the correction of CAS noncompliances and the recovery of any increased costs due to the Government for the reported CAS noncompliances.

(U) DCMA Contracting Officers Did Not Comply With the FAR When They Settled 14 DCAA Audit Reports

(U) For 14 of the 30 DCAA audit reports we reviewed, DCMA contracting officers did not comply with the requirements of the FAR when they settled DCAA audit reports associated with two of the largest DoD contractors. Specifically, the contracting officers did not:

- (U) adequately document or explain why they disagreed with \$97 million in questioned costs from eight DCAA incurred cost audit reports as required by FAR 42.705-1(b)(5)(iii) and DoD Instruction 7640.02; or
- (U) comply with FAR 30.605 and DCMA Instruction 108 when they took action to settle six DCAA CAS audit reports.¹⁸

(U) Appendix B lists the 30 audit reports we selected for evaluation and identifies the 14 audit reports where we found the noncompliances.

(U) DCMA Contracting Officers Did Not Comply With the FAR and DoD Instruction 7640.02 When They Settled Eight DCAA Incurred Cost Audit Reports

(U) Our selection of 30 DCAA audit reports included 18 reports of incurred costs at Contractor A or Contractor B. For 8 of the 18 DCAA incurred cost audit reports, DCMA contracting officers did not adequately document or explain actions they took to settle \$97 million in questioned costs, as required by FAR 42.705-1(b)(5)(iii) and DoD Instruction 7640.02. Table 1 shows the amount of DCAA questioned costs by DCAA audit report where the DCMA contracting officers did not adequately document or explain actions.

¹⁸ (U) FAR 42.705-1, "Contracting officer determination procedure."

(U) Table 1. DCAA Questioned Costs Where DCMA Contracting Officers Did Not Adequately Document or Explain Actions

	DCAA Audit Report Number	DCAA Questioned Cost	Questioned Cost Where DCMA Contracting Officers Did Not Adequately Document or Explain Actions
1	3121-2010K10100001S1	\$87,866,143	\$405,908
2	3121-2009K10100001S1	21,182,674	995,479
3	3221-2010T10100001	115,855,130	3,720,165
4	3221-2011T10100001	120,862,868	7,691,554
5	3711-2010A10100001	14,926,892	5,136,445
6	7611-2013H10100001	131,145,012	11,960,722
7	7631-2012T10100001	84,639,749	29,694,887
8	7631-2013T10100001	88,716,104	37,284,780
	Total	\$665,194,572	\$96,889,940

(U) Source: The DoD Office of Inspector General, based on DCAA and DCMA data.

(U) FAR 42.705-1(b)(5)(iii) requires the contracting officer to prepare, sign, and place in the contract file a negotiation memorandum covering reasons why any recommendations of the auditor or other Government advisors were not followed. In addition, DoD Instruction 7640.02 and DCMA Instruction 126 require the contracting officer to indicate whether or not each DCAA finding or recommendation is agreed to, and, if not, document the rationale for the disagreement in the negotiation memorandum. For \$97 million of the \$665 million questioned by the DCAA, DCMA contracting officers did not document adequate rationale for disagreeing with the DCAA finding or recommendation.

(U) For example, the DCMA CACO responsible for settling DCAA Audit Report No. 7631-2012T10100001 did not document adequate rationale for disagreeing with the DCAA on \$30 million of \$85 million in reported questioned costs. The \$30 million included \$6 million in costs claimed by Contractor B for a Supplemental Executive Retirement Plan, which is the highest dollar account for which we disagreed with the CACO's rationale. The DCAA questioned Supplemental Executive Retirement Plan costs associated with salaries in excess of the compensation limitation as unallowable directly associated costs, in accordance with FAR 31.201-6.¹⁹ However, the CACO allowed the \$6 million

¹⁹ (U) FAR 31.201-6, "Accounting for unallowable costs." A directly associated cost is any cost that is generated solely as a result of incurring another cost and that would not have been incurred had the other cost not been incurred. The compensation limitation is the maximum allowable amount that can be claimed for the compensation of a contractor employee in accordance with FAR 31.205-6(p).

(U) in Supplemental Executive Retirement Plan costs claimed by Contractor B based on the CACO's interpretation of FAR 31.205-6(p).²⁰ The CACO documented on the negotiation memorandum that he allowed the costs due to conflicting arguments between Contractor B and the DCAA and the lack of a regulatory basis for defining a reasonable defined benefit cost. Furthermore, the CACO documented that he was able to get concessions from Contractor B on other points of contention, such as statistical projections.

(~~PRIVILEGE~~//AC) We determined that the CACO documented inadequate rationale for disagreeing with the DCAA audit report. Although FAR 31.205-6 does not set limits on defined benefit costs, FAR 31.201-6(a) states that when an unallowable cost is incurred, its directly associated costs are also unallowable. The CACO's settlement of the questioned costs should have been based on whether the FAR designates the costs as unallowable, not whether Contractor B made concessions in other unrelated areas. Therefore, the Supplemental Executive Retirement Plan costs, which were directly associated with unallowable costs, should not have been allowed by the CACO. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The remaining \$24 million in questioned costs included various types of costs for which the CACO did not adequately explain why he disagreed with the DCAA. In most instances, the CACO accepted the contractor claimed costs that were billed to the Government at a higher amount than the amounts outlined in the contract or the CACO accepted the costs based on the CACO's analysis that was not documented in the negotiation file.

(U) In a second example, DCAA Audit Report No. 7611-2013H10100001 questioned \$12 million of Contractor B's claimed Vendor Services costs as unallowable per FAR 31.201-2 because Contractor B did not provide sufficient and adequate documentation to support the allowability of the costs.²¹ Contractor B provided invoices to support the costs, but the DCAA auditor determined that the invoices did not contain details necessary to determine allowability and reasonableness of the claimed costs. For instance, the invoices did not include the billed rate per unit that Contractor B and the vendor had agreed to. However, based on

²⁰ (U) FAR 31.205-6, "Compensation for personal services." Compensation for personal services is allowable subject to the general criteria and requirements found within FAR 31.205-6. Paragraph (p) of FAR 31.205-6 establishes the limitation on allowability of compensation.

²¹ (U) FAR 31.201-2, "Determining allowability."

(U) the same invoices, the DACO allowed the costs but did not provide an adequate explanation for why he considered Contractor B's invoices sufficient and adequate documentation to support the allowability of the \$12 million in claimed Vendor Services costs.

(U) For the remaining six DCAA incurred cost audit reports, the DCMA contracting officers similarly allowed the contractors' claimed costs of \$55 million but did not adequately document or explain why they disagreed with the DCAA. Therefore, we concluded that the DCMA contracting officers did not comply with FAR subpart 42.7 and DoD Instruction 7640.02 for the eight audit reports.

(U) DCMA Contracting Officers Did Not Comply With the FAR and DCMA Instruction 108 When They Took Action on Six Cost Accounting Standards Noncompliance Audit Reports

(U) For the 30 DCAA audit reports we reviewed, 8 involved DCAA reporting of CAS noncompliances at Contractor A or Contractor B. For six of the eight DCAA CAS audit reports, DCMA contracting officers did not comply with FAR 30.605 and DCMA Instruction 108 when they took, or failed to take, action on the reported CAS noncompliances. All six reports addressed Contractor A. Specifically, the DCMA contracting officer for:

- (U) four of the six DCAA CAS audit reports did not notify contractors within 15 days of the potential CAS noncompliances;
- (U) one of the six reports did not issue a final determination of compliance or noncompliance; and
- (U) one of the six reports did not obtain the cost impact from the contractor for the noncompliant practice.

(U) According to FAR 30.605 and DCMA Instruction 108, the key requirements for the DCMA contracting officer include:

- (U) within 15 days of receiving a DCAA audit report, notify the DCAA that the contracting officer disagrees with the reported noncompliance or issue a notice of potential noncompliance to the contractor if the contracting officer agrees with the reported noncompliance;
- (U) issue a determination of compliance or noncompliance consistent with FAR 1.704; and
- (U) obtain a cost impact from the contractor for the noncompliance in accordance with 48 CFR 9903.305.²²

²² (U) Title 48 Code of Federal Regulation section 9903.305, "Materiality," April 17, 1992.

(U) The DACOs Exceeded the 15-Day Requirement to Notify Contractors of a Potential CAS Noncompliance on Four Audit Reports

(U) For four of the six DCAA CAS audit reports, the DACOs exceeded the 15-day requirement established in FAR 30.605(b)(1) and DCMA Instruction 108 for issuing a notice of potential CAS noncompliance to the contractor. On average, the DACOs took 95 days to issue the notices of potential CAS noncompliance. Table 2 identifies, by DCAA audit report, the number of days that the DACOs exceeded the 15-day requirement.

(U) Table 2. Number of Days DACOs Exceeded the FAR Requirement for Issuing a Notice of Potential CAS Noncompliance

	DCAA Audit Report Number	DCAA Audit Report Date	Date of Notification of Potential CAS Noncompliance	Number of Days DACOs Exceeded the 15-day Requirement
1	3121-2014K19200004	4/29/2015	9/9/2015	118
2	3531-2011L19200003	9/29/2016	11/15/2016	32
3	6501-2015C19200001	7/20/2016	12/12/2016	130
4	6501-2015C19200002	7/7/2016	10/18/2016	98
	Average Days Exceeding the FAR Requirement			95

(U) Source: DoD Office of Inspector General, based on DCMA data.

(U) The DCMA contract files for all four reports did not include a justification for exceeding the 15-day requirement. The DACOs who were originally assigned to three of the four audit reports are no longer employed by the DCMA. The contract files did not include a justification for significantly exceeding the 15-day FAR requirement. Timely processing of noncompliances is important to ensure the contractor promptly corrects the noncompliant practice and the Government recoups any costs resulting from the noncompliance.

(U) The CACO Did Not Make a Final Determination of Compliance or Noncompliance for One Audit Report

(U) For one of the six DCAA CAS audit reports, the CACO did not make a final determination of compliance or noncompliance for the reported noncompliance. Specifically, the DCAA reported in DCAA Audit Report No. 6631-2016C19200001 that Contractor A did not comply with CAS 405, "Accounting for unallowable costs," because Contractor A used estimates for recognizing unallowable labor that could

(U) not be verified by the DCAA. The DCAA audit report did not provide an estimated impact to the Government, but it stated that the CAS 405 noncompliance began in FY 2009 and the contractor had not corrected it as of September 2016, when the DCAA issued the audit report.

(U) The CACO issued a notice of potential noncompliance with CAS 405 to Contractor A on September 20, 2016. Although Contractor A disagreed with the potential CAS 405 noncompliance, Contractor A later implemented a new timekeeping policy in November 2016 to better identify unallowable labor. The CACO determined that the new policy eliminated the deficiencies cited in the initial notice of potential CAS 405 noncompliance. However, the CACO's final determination did not state whether Contractor A's prior practice did or did not comply with CAS 405 or provide the CACO's basis for determining that the new timekeeping policy eliminated the reported noncompliance, as required by FAR 30.605(b)(3) and DCMA Instruction 108. The CACO closed the record in the CAFU system without making a determination on the past practice. The CACO who took action on DCAA Audit Report No. 6631-2016C19200001 left the agency in January 2020, prior to the completion of our evaluation of the CACO's actions. The newly assigned CACO stated that the determination of compliance or noncompliance with CAS 405 had been inadvertently excluded from the final determination letter and that a cost impact for the past practice was not obtained from Contractor A.

(U) As required by FAR 30.605(b)(3), DoD Instruction 7640.02, and DCMA Instruction 108, the CACO should have made a determination of compliance or noncompliance with CAS 405 on Contractor A's past practice.

(U) The CACO Did Not Obtain a Cost Impact for One Audit Report

(U) For one of the six reports, the CACO did not obtain a cost impact to determine the materiality of a noncompliance to the Government. Specifically, the DCAA reported in DCAA Audit Report No. 6631-2016C19200002 an ongoing noncompliance with CAS 403 and CAS 416 related to Contractor A's allocation of group insurance costs.

(U) In 2002, the DCAA had originally reported on the same noncompliance and the former CACO determined at that time that the noncompliance was immaterial. However, the former CACO further stated that if the cost impact became material in the future, the Government would take action. On September 1, 2016, the DCAA issued Report No. 6631-2016C19200002 regarding this noncompliance and concluded that the CAS 403 and CAS 416 noncompliance had become material starting in FY 2009 and had not been corrected as of September 2016, however, the report did not provide an estimated impact to the Government.

(U) On September 20, 2016, the CACO agreed with the DCAA and issued a notice of potential noncompliance to Contractor A. The contractor initially responded that the former CACO reviewed and accepted this practice, with certain provisions, and determined that the noncompliance was immaterial and that a cost impact was not required. Subsequent to the notice of potential noncompliance, the contractor proposed a change to its practice that the DCAA and the CACO determined did not resolve the CAS 403 and CAS 416 noncompliance. Without a compliant CAS practice or a determination on materiality, the CACO closed the CAFU system record in May 2017. As of September 30, 2020, more than 2 years later, the CACO had not made a determination of compliance or noncompliance on the proposed change or obtained a cost impact for the ongoing CAS 403 and CAS 416 noncompliance, as required by FAR 30.605 and DCMA Instruction 108. The CACO explained that not issuing a determination or obtaining a cost impact was a result of the contractor not formally proposing a compliant practice and not receiving a requested review from the DCMA legal office. However, the delays encountered with the contractor and the DCMA legal office do not justify closing the record in the CAFU system before completing the actions required by FAR 30.605 and DCMA Instruction 108.

(U) DCMA Contracting Officers Complied With the FAR When They Settled 16 of 30 Audit Reports

(U) For 16 of 30 DCAA audit reports we reviewed, the DCMA contracting officers complied with the FAR, DoD Instruction 7640.02, and DCMA policy when they settled the \$369 million in questioned costs, CAS noncompliances, and business system deficiencies reported by the DCAA. The 16 reports consisted of 10 incurred cost reports, 2 CAS audit reports, and 4 business system deficiency reports. Appendix B lists the 30 audit reports selected for evaluation, including the 16 DCAA audit reports for which the DCMA contracting officers complied with the Federal and DoD regulations, DoD Instruction 7640.02, and DCMA policy.

(U) We found that an effective working relationship with the DCAA, fostered by DCMA's organizational change to focus on the 40 largest DoD contractors, and DCMA's performance of peer reviews contributed to DCMA contracting officers taking appropriate actions on the 16 reports. Below are two examples of the 16 DCAA audit reports for which the DCMA contracting officers complied with the FAR, DoD Instruction 7640.02, and DCMA policy.

(U) In DCAA Audit Report No. 6631-2011C10100599, the DCAA questioned \$31 million of the claimed corporate programs costs and corporate overhead costs for Contractor A, in accordance with FAR subpart 31.2. The CACO sustained \$13 million of the questioned costs and documented his rationale for not upholding

(U) the remaining \$18 million in accordance with the FAR, DoD Instruction 7640.02, and DCMA Instruction 125. In close consultation with the DCAA, the CACO obtained and reviewed additional evidence from the contractor, and the CACO correctly obtained DCAA concurrence when making a determination to allow the remaining \$18 million in DCAA reported questioned costs.

(U) In DCAA Audit Report No. 3161-2016F19200001, the DCAA identified Contractor B's practice for accumulating depreciation to be in noncompliance with CAS 409.²³ The DACO notified the contractor of the potential noncompliance within the 15-day requirement, obtained the contractor's response to the reported noncompliance, and issued the final decision, in accordance with the requirements of FAR 30.605, DoD Instruction 7640.02, and DCMA Instruction 108. The DACO participated in a peer review of the negotiation documents with other DACOs within Contractor B's network, obtained a legal review, and obtained the DCAA's opinion on the negotiation memorandum prior to issuing the final determination of noncompliance with CAS 409 and the determination that the impact was immaterial.

(U) Three Factors Contributed to the DCMA Contracting Officers' Noncompliance With the FAR, DoD Instruction 7640.02, and DCMA Policy

(U) We identified the following three factors that contributed to the DCMA contracting officers' noncompliance with the FAR, DoD Instruction 7640.02, and DCMA policy when they settled the 14 DCAA audit reports.

- (U) DCMA contracting officers did not obtain a required legal review.
- (U) DCMA supervisors did not provide effective oversight of DCMA contracting officers' actions.
- (U) DCMA contracting officers did not maintain detailed contract file documentation, such as documents provided by the contractor during negotiation, to support not upholding DCAA findings and recommendations.

(U) Appendix C identifies the factors applicable to each DCAA audit report.

²³ (U) CAS 409 is located in Title 48, Code of Federal Regulation, section 9904.409, "Depreciation of Tangible Capital Assets," April 17, 1992.

(U) DCMA Contracting Officers Did Not Obtain a Required Legal Review Prior to Settling the Questioned Costs or CAS Noncompliance

(U) For 4 of the 14 DCAA audit reports, the DCMA contracting officers did not obtain a required legal review prior to settling the DCAA questioned costs or CAS noncompliance with the contractor. DoD Instruction 7640.02, Enclosure 3, paragraph 3(b), and DCMA Instruction 126 require that DCMA 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 four instances, the DCMA contracting officers' disagreement was based on an interpretation of the FAR that differed from the DCAA's interpretation and should have had a legal review.

(U) For example, in DCAA Audit Report Numbers 7631-2012T10100001 and 7631-2013T10100001, the DCAA questioned a total of \$7.7 million in accordance with FAR 31.203(c).²⁴ The DCAA questioned the costs because the indirect information technology and occupancy cost base used by Contractor B to allocate the indirect costs to the entire company did not include unallowable costs incurred by Contractor B. The CACO did not sustain \$5 million of the \$7.7 million based on the outcome of an Armed Services Board of Contract Appeals case.²⁵ Although the CACO indicated in the negotiation memorandum that the circumstances of the questioned costs were similar to those discussed in the Armed Services Board of Contract Appeals case, the CACO failed to consult legal counsel on his interpretation of the FAR or the Armed Services Board of Contract Appeals case, as required by DoD Instruction 7640.02 and DCMA Instruction 126. Consulting legal counsel would have helped to ensure that the CACO properly determined the relevance and applicability of the Armed Services Board of Contract Appeals decision to the DCAA audit report findings.

(U) When DCMA contracting officers do not obtain a required legal review, they bypass a key control established by the DoD and the DCMA to help ensure that DCMA contracting officer determinations comply with applicable regulations and DoD policy. Therefore, we concluded that a lack of obtaining a legal review contributed to DCMA contracting officers not documenting adequate rationale for disagreeing with the DCAA on 4 of the 14 DCAA audit reports.

²⁴ (U) FAR 31.203, "Indirect Costs," requires the contractor to accumulate indirect cost by logical groupings and to select an allocation base to allocate the groupings that is common to all cost objectives. The FAR further states that all items properly includable in an indirect cost base must bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs.

²⁵ (U) The Armed Services Board of Contract Appeals is a neutral, independent forum that hears and decides post-award contract disputes between Government contractors and the DoD, the National Aeronautics and Space Administration, the Central Intelligence Agency, and other entities. The majority of Armed Services Board of Contract Appeals matters involve contractors that appeal a Government contracting officer final decision or a failure to issue a decision.

(U) In September 2019, in response to a prior DoD Office of Inspector General (OIG) Report No. DODIG-2019-070, the DCMA contracting officers attended training that emphasized the requirement to consult with the legal counsel when they disagree with the DCAA based on an interpretation of a law or regulation, and document the rationale for the disagreement and the results of the legal consultation in accordance with DCMA Instruction 126.²⁶ The September 2019 training occurred after the contracting officers took action on the five DCAA audit reports. As a result, we are not making a recommendation for this contributing factor.

(U) DCMA Supervisors Did Not Provide Effective Oversight of DCMA Contracting Officers' Actions

(U) For 14 of the 30 DCAA audit reports we reviewed, we determined that the supervisors of the DCMA contracting officers did not provide effective oversight of the contracting officer actions on the reports. DCMA Instruction 126, Paragraph 3.9.10, requires supervisors to sign the contracting officer's negotiation memorandum, which reflects their review and concurrence of the DCMA contracting officer actions. In all 14 instances, the supervisors signed the negotiation memorandum even though the DCMA contracting officer's actions did not comply with the FAR, DoD Instruction 7640.02, and DCMA policy. Specifically, the supervisors did not ensure that for:

- (U) 8 of the 18 DCAA incurred cost audit reports, the contracting officers documented adequate rationale when they disagreed with the DCAA findings and recommendations;
- (U) 4 of the 18 DCAA incurred cost audit reports, the contracting officers obtained a required DCMA legal opinion when they disagreed with DCAA recommendations; and
- (U) 6 of the 8 DCAA CAS audit reports, the contracting officers complied with FAR 30.605 when they took action to address the reported CAS noncompliances.

(U) Supervision is a key control for monitoring contracting officer actions. However, the supervisor signatures in this case did not serve as an effective control for ensuring that DCMA contracting officers completed all actions appropriately to settle the 14 DCAA audit reports. An effective supervisory review of the DCMA contracting officers' negotiation memorandums should have identified that the DCMA contracting officers did not take the necessary actions to settle the DCAA audit reports and would have prompted the supervisors to request that the DCMA contracting officers take corrective actions.

²⁶ (U) 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.

(U) DCMA Contracting Officers Did Not Maintain Contract File Documentation

(U) For 7 of the 14 DCAA audit reports, DCMA contracting officers did not maintain key contract file documentation to support actions the DCMA took on the DCAA questioned costs, such as documents provided by the contractor during negotiation in support of allowing the DCAA questioned costs and other key evidence. FAR subpart 4.8 identifies the requirements for establishing, maintaining, and disposing of contract files.²⁷ FAR subpart 4.8 requires establishing contract files that contain the records of all contractual actions and maintaining documentation within the contract files to support actions taken by the contracting office.

(U) For example, the DCMA DACO responsible for settling DCAA Audit Report No. 3711-2010A10100001 did not retain documentation to support the reason for disagreeing with the DCAA on \$5 million of the \$15 million in reported questioned costs. The \$5 million of questioned costs included \$0.6 million for indirect technical services costs questioned by the DCAA because Contractor A paid the vendor at a higher rate than the rate stated in the service agreement and initial quote. According to the negotiation memorandum, the DACO did not sustain the \$0.6 million because Contractor A provided additional documentation to support its claimed costs during negotiations. The DACO responsible for taking action on DCAA Audit Report No. 3711-2010A10100001 left the agency. The current DACO could not locate the files identified in the negotiation memorandum that the former DACO used as the basis to allow the \$0.6 million in DCAA questioned costs. We could not confirm that the supporting documentation ever existed. The remaining \$4.4 million of the \$5 million included various types of costs (legal fees, photo print, property rental, and technical services) for which the DACO did not adequately document or explain why the amount questioned by the DCAA was not sustained. For the remaining six DCAA audit reports, the DCMA contracting officers similarly did not retain documentation within the contract file that would have supported the actions they took to settle the DCAA audit reports.

(U) We also determined that the DCMA did not have an adequate policy which required that contracting officers retain key documents needed to support their actions on DCAA audit reports in the DCMA official electronic contract filing system. In October 13, 2015, the DCMA issued Memorandum No. 15-202 that officially identified the Electronic Document Records Management System

²⁷ (U) FAR subpart 4.8, "Government Contract Files."

(U) as the DCMA's official electronic contract file system.²⁸ However, neither the memorandum nor the DCMA manuals (which implement DCMA policy) prescribe the types of key documents that should be included in the Electronic Document Records Management System to support contracting officer actions on DCAA audit reports.

(U) DCMA Contracting Officers May Have Reimbursed DoD Contractors Up to \$97 Million in Costs That May Not Be Allowable on Government Contracts

(U) For 14 of the 30 DCAA audit reports we reviewed, DCMA contracting officers did not comply with the FAR when they settled the DCAA audit reports. DCMA contracting officer actions on 8 of the 30 DCAA audit reports may have resulted in improperly reimbursing DoD contractors up to \$97 million in costs that may be unallowable on Government contracts. For six additional reports, the DCMA contracting officers did not issue a notice of potential noncompliance within 15 days on the DCAA reported CAS noncompliance, make a determination of CAS compliance or noncompliance, or determine the cost impact to the Government from Contractor A. The contracting officers' untimely actions delayed the correction of the noncompliances and the recovery of any increased cost due the Government.

(U) Recommendations, Management Comments, and Our Response

(U) Recommendation 1

(U) We recommend that the Defense Contract Management Agency Director take the following steps for the eight audit reports listed in Appendix B for which the contracting officer did not adequately document or adequately explain the reason for disagreeing with the Defense Contract Audit Agency:

- a. (U) Reopen the audit report in the Contract Audit Follow-up System until all findings are settled.
- b. (U) Review the contracting officer's decision to not uphold the \$97 million in Defense Contract Audit Agency questioned costs and determine whether the costs are unallowable in accordance with the Federal Acquisition Regulation.
- c. (U) Disallow and recoup any unallowable costs not previously disallowed.

²⁸ (U) DCMA Memorandum No. 15-202, "Automated IWMS eDRMS Contract Records Maintenance," October 13, 2015.

(U) Defense Contract Management Agency Comments

(U) The DCMA Director agreed with the recommendation. The Director stated that the DCMA is currently reviewing its files for any additional documentation that may further justify the contracting officer determinations on the eight incurred cost audit reports. The Director also stated that, to the extent the DCMA cannot find adequate information in its files to justify the contracting officer determinations, the DCMA will take the specific recommended actions. The DCMA plans to complete the recommended actions by June 30, 2021.

(U) Our Response

(U) Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA reopened the reports in the CAFU System, reviewed the contracting officers' decision, and recouped any unallowable costs.

(U) Recommendation 2

(U) We recommend that the Defense Contract Management Agency Director remind all Defense Contract Management Agency contracting officers in writing of the requirement to issue a notice of potential Cost Accounting Standard noncompliance within 15 days of receipt of a reported Cost Accounting Standard noncompliance, in accordance with Federal Acquisition Regulation 30.605(b)(1) and Defense Contract Management Agency Instruction 108.

(U) Defense Contract Management Agency Comments

(U) The DCMA Director agreed with the recommendation and stated that the DCMA plans to complete the recommended actions by June 30, 2021. The DCMA Director further stated that the DCMA will provide the DoD OIG with a copy of the written communication reminding DCMA contracting officers of the 15-day requirement to issue a notice of potential CAS noncompliance.

(U) Our Response

(U) Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA has reminded all DCMA contracting officers in writing of the 15-day requirement.

(U) Recommendation 3

(U) We recommend that the Defense Contract Management Agency Director require the contracting officers for Audit Report Numbers 6631-2016C19200001 and 6631-2016C19200002 to take the following actions in accordance with Federal Acquisition Regulation 30.605 and Defense Contract Management Agency Instruction 108:

- a. (U) Reopen the audit report in the Contract Audit Follow-up System until all findings are settled.
- b. (U) Make a determination of Cost Accounting Standards compliance (if applicable).
- c. (U) Based on the results of the review in Recommendation 3.b, take steps to:
 1. (U) notify the contractor of the compliance determination;
 2. (U) make a determination on the cost impact; and
 3. (U) recoup any cost increase to the Government as a result of the noncompliances.

(U) Defense Contract Management Agency Comments

(U) The DCMA Director agreed with the recommendation. The Director stated that the DCMA is reviewing its files for any additional documentation that will justify the contracting officer decisions. The Director also stated that, to the extent the DCMA cannot find adequate information in its files to justify the contracting officer determinations, the DCMA will take the specific recommended actions. The DCMA plans to complete the recommended actions by June 30, 2021.

(U) Our Response

(U) Comments from the Director addressed the specifics of the recommendations. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA has reopened the report in the CAFU System, made a determination on CAS compliance, and taken steps to notify the contractor, determine cost impact, and recoup any cost increase to the Government.

(U) Recommendation 4

(U) We recommend that the Defense Contract Management Agency Director require the supervisors of the contracting officers for the 14 audit reports listed in Appendix C to receive training on the level of review necessary to provide an effective control for ensuring that contracting officers complete actions appropriately when addressing Defense Contract Audit Agency audit reports.

(U) Defense Contract Management Agency Comments

(U) The DCMA Director agreed with the recommendation and stated that the DCMA plans to provide training to the DCMA supervisors assigned to the 14 audit reports by September 30, 2021.

(U) Our Response

(U) Comments from the Director addressed the specifics of the recommendations. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA supervisors assigned to the 14 audit reports have completed the training.

(U) Recommendation 5

(U) We recommend that Defense Contract Management Agency Director implement a policy which requires contracting officers to retain key documents that support their actions on audit reports in Defense Contract Management Agency's Electronic Document Records Management System.

(U) Defense Contract Management Agency Comments

(U) The DCMA Director agreed with the recommendation and stated that DCMA plans to implement a new records management and retention manual that will clearly indicate which records should be retained, where records should be stored, and how long they should be retained. The DCMA plans to complete the recommended action by December 31, 2021.

(U) Our Response

(U) Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA has implemented a policy that requires a contracting officer to retain key documents in the DCMA Electronic Document Records Management System.

(U) Appendix A

(U) Scope and Methodology

(U) We conducted this evaluation from July 2019 through September 2020 in accordance with the “Quality Standards for Inspection and Evaluation,” published in January 2012 by the Council of Inspectors General on Integrity and Efficiency. Those standards require that we plan and perform 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, conclusions, 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.

(U) Sample Selection of DCAA Audit Reports for Review

(U) To accomplish our objective, we evaluated the actions that DCMA contracting officers took on 30 DCAA audit reports involving Contractor A and Contractor B. Of the 30 DCAA reports, 15 reports addressed Contractor A and 15 reports addressed Contractor B. We non-statistically selected the 30 DCAA audit reports from a universe of 222 audit reports that identified findings and recommendations for Contractors A and B, and settled by DCMA contracting officers between April 2016 and March 2019. The DCAA issued the 30 audit reports to the DCMA contracting officers for action from April 2015 through February 2018, and the DCMA contracting officers settled the 30 audit reports from October 2016 through September 2018.

(U) To help ensure that we selected a reasonable cross-section of audit reports, we grouped the 222 DCAA reports by audit type. Table 4 identifies the selection of DCAA reports by audit type.

(U) Table 4. List of DCAA Reports Selected by Audit Type

Audit Type	Reports Addressing Contractor A	Reports Addressing Contractor B	Total Reports Addressing Contractors A and B	Number Selected
Incurred Cost	59	79	138	18
Cost Accounting Standards	16	18	34	8
Business System	8	27	35	4
Terminations	4	3	7	0
Earned Value Management	3	1	4	0
Defective Pricing	3	0	3	0
Operations	1	0	1	0
Total	94	128	222	30

(U) Source: DoD OIG, based on DCAA and DCMA data.

(U) We determined that the 30 reports would result in a reasonable cross-section of the 222 DCAA reports. The following describes our selection methodology for each type of report.

- (U) Our non-statistical selection of the 18 incurred cost reports was based on the degree to which the contracting officer upheld the DCAA questioned costs. For all 18 audit reports we selected, the contracting officers upheld less than 50 percent of the DCAA reported questioned costs.
- (U) Our non-statistical selection of the 8 CAS audit reports was based on selecting a variety of contracting officers assigned to Contractor A and Contractor B.
- (U) Our non-statistical selection of the 4 business system deficiency reports from was based on selecting a variety of contracting officers assigned to Contractor A and Contractor B.

(U) Appendix B identifies the list of DCAA audit reports we selected by DCAA audit report type and contractor.

(U) Review of Documentation and Interviews

(U) For the 30 DCAA audit reports we selected for review, we:

- (U) gained an understanding of the functions and responsibilities of the DCMA CACO and DACO teams for the two of the largest DoD contractors;
- (U) obtained and evaluated the established agency policies of the DCMA CACOs and DACOs teams for addressing DCAA findings and recommendations;

- (U) gained an understanding of the 30 DCAA audit reports and associated supporting DCAA audit working papers;
- (U) interviewed DCAA auditors who conducted the audits, as needed;
- (U) interviewed DCMA contracting officers and any other DCMA personnel involved with taking action on the DCAA audit reports;
- (U) obtained and evaluated DCMA contracting officer negotiation memorandums and any other records that documented the actions taken by the contracting officers on the DCAA audit report findings and recommendation; and
- (U) evaluated DCMA contracting officer actions taken on the DCAA audit report findings and recommendations for compliance with the FAR, DoD Instruction 7640.02, and DCMA policy.

(U) As necessary, we conducted site visits at the DCMA contract field offices for Contractor A and Contractor B. In addition, we held teleconferences with the following DCMA management personnel.

- (U) Director Cost and Pricing Regional Command
- (U) Director of the Corporate Divisional Administrative Contracting Officer Group
- (U) DCMA CACO and DACO Team Leads for Contractor A and Contractor B

(U) Criteria

(U) We reviewed criteria from Federal laws and regulations, DoD directives, instructions, manuals, and policy memorandums. We also reviewed criteria from DCMA and DCAA manuals and other policies. The following criteria were most pertinent to our evaluation and conclusions in this report.

(U) Laws and Regulations

- (U) FAR Part 30, “Cost Accounting Standards Administration”
- (U) FAR Part 31, “Contract Cost Principles and Procedures”
- (U) FAR Part 42, “Contract Administration and Audit Services”
- (U) DFARS Part 242, “Contract Administration”

(U) DoD Directives, Instruction, Manuals, and Policy Memorandums

- (U) DoD Instruction 7640.02, “Policy for Follow-Up on Contract Audit Reports,” April 15, 2015
- (U) DoD Directive 5105-36, “Defense Contract Audit Agency,” January 4, 2010
- (U) DoD Directive 5105-64, “Defense Contract Management Agency,” January 10, 2013

(U) Defense Contract Management Agency Instructions

- (U) DCMA Instruction 108, “Cost Accounting Standards Administration,” April 3, 2013
- (U) DCMA Instruction 125, “Final Overhead Rates,” April 21, 2014
- (U) DCMA Instruction 126, “Contract Audit Follow-Up,” February 11, 2016
- (U) DCMA Instruction 131, “Contractor Business System,” December 1, 2015

(U) Use of Computer-Processed Data

(U) In selecting the 30 DCAA audit reports, we obtained a list of DCAA audit reports issued on Contractor A and Contractor B and settled by DCMA contracting officers between March 2016 and March 2019 in the CAFU system. We generated the list of audit reports from the CAFU system. We tested the reliability of the list of DCAA audit reports by tracing the 30 selected audit reports to source documents and determined that the data in the list were reliable.

(U) Prior Coverage

(U) DoD OIG

(U) During the last 5 years, the DoD OIG issued five reports that addressed DCMA contracting officer actions on DCAA audit reports and that involved the two largest DoD contractors in the sample selection. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/reports.html/>.

(U) Report No. DODIG-2020-049, “Evaluation of Defense Contract Management Agency Contracting Officers Actions on Penalties Recommended by the Defense Contract Audit Agency,” January 10, 2020

(U) 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. DCMA contracting officers did not adequately explain why they disagreed with the DCAA’s recommendations to assess penalties on \$43 million in unallowable indirect costs.

(U) Report No. DODIG 2020-36, "Evaluation of Contracting Officer Actions on Defense Contract Audit Agency Audit Reports that Disclaim an Opinion," November 26, 2019

(U) We evaluated contracting officer actions on 21 DCAA audit reports that disclaimed an opinion, but questioned \$750 million. DCMA contracting officers were responsible for taking action on 20 of the reports, and Naval Supply Systems Command contracting officers were responsible for taking action on 1 of the reports. For 19 of the 21 audit reports, DCMA contracting officers took appropriate action on the DCAA's audit findings. However, for 2 of the 21 DCAA audit reports, DCMA contracting officers did not document adequate rationale for disagreeing with \$219 million in DCAA questioned costs.

(U) 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

(U) We evaluated DCMA contracting officer actions on DoD contractor executive compensation questioned by the DCAA on 35 DCAA audit reports. As a result of not sustaining the DCAA recommendations, the contracting officers reimbursed DoD contractors \$22.5 million in executive compensation that the DCAA reported as unreasonable in 18 audit reports.

(U) 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

(U) We evaluated the appropriateness of DCMA actions on DCAA findings reported in 22 incurred cost audit reports. In eight instances, contracting officers did not address direct costs questioned by the DCAA totaling \$305 million.

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

(U) We evaluated the appropriateness of DCMA contracting officer actions on DCAA findings reported in 27 CAS audit reports. In 16 instances, contracting officers did not complete all actions on Defense Contract Audit Agency-reported noncompliances within the required timeframes.

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

(U) We evaluated the appropriateness of DCMA actions on DCAA findings reported in 21 business system deficiency reports. DCMA contracting officers did not (1) issue timely determinations on reported deficiencies, (2) obtain or adequately evaluate contractor responses, or (3) withhold payments from the contractor's billings to protect the Government's interests.

(U) Appendix B

(U) This appendix identifies the 30 DCAA audit reports in our sample, listed by DCAA audit report and contractor. In addition, the appendix identifies the 14 audit reports for which we found the noncompliances with the FAR when the contracting officers settled the DCAA audit reports.

(U) Table 5. Instances in Which DCMA Contracting Officers Did Not Comply With the FAR, by DCAA Audit Report

	DCAA Audit Report Number	Inadequate Rationale (FAR 42.705-1(b)(5)(iii))	Unsettled CAS Noncompliance or Untimely CAS Noncompliance Notification (FAR 30.605)
	Contractor A		
1	3121-2009K10100001S1	X	
2	3121-2010K10100001S1	X	
3	3121-2011K10100001		
4	3121-2012K10100001		
5	3711-2010A10100001	X	
6	5211-2012A10100001		
7	6631-2011C10100599		
8	6631-2012C10100003		
9	3121-2014K19200004		X
10	3531-2011L19200003		X
11	6501-2015C19200001		X
12	6501-2015C19200002		X
13	6631-2016C19200001		X
14	6631-2016C19200002		X
15	5211-2016A24010001		
	Contractor B		
16	3221-2009I10100001		
17	3221-2010I10100001		
18	3221-2010T10100001	X	
19	3221-2011T10100001	X	
20	3221-2012I10100001		
21	4611-2011H10100001		
22	7611-2013E10100001		

(U) Table 5. Instances in Which DCMA Contracting Officers Did Not Comply With the FAR, by DCAA Audit Report

	DCAA Audit Report Number	Inadequate Rationale (FAR 42.705-1(b)(5)(iii))	Unsettled CAS Noncompliance or Untimely CAS Noncompliance Notification (FAR 30.605)
23	7611-2013H10100001	X	
24	7631-2012T10100001	X	
25	7631-2013T10100001	X	
26	4821-2016R11090001		
27	4621-2016Y11090001		
28	7281-2017C11090002		
29	3161-2016F19200001		
30	7631-2017I19500002		
	Total	8	6

(U) Source: DoD OIG, based on DCMA data.

(U) Appendix C

(U) This appendix lists the DCAA audit reports and the factors that contributed to the contracting officer noncompliances with the FAR and DoD Instruction 7640.02 when they settled the selected DCAA audit reports.

(U) Table 6. Contributing Factors for Not Complying With the FAR and DoD Instruction 7640.02

	DCAA Audit Report Number	Contracting Officer Did Obtain Required Legal Review	Ineffective Supervisory Oversight	Inadequate Contract File Documentation
	Contractor A			
1	3121-2009K10100001S1	X	X	X
2	3121-2010K10100001S1		X	X
3	3711-2010A10100001		X	X
4	3121-2014K19200004		X	
5	3531-2011L19200003		X	
6	6501-2015C19200001		X	
7	6501-2015C19200002		X	
8	6631-2016C19200001	X	X	
9	6631-2016C19200002		X	
	Contractor B			
10	3221-2010T10100001		X	X
11	3221-2011T10100001		X	X
12	7611-2013H10100001		X	
13	7631-2012T10100001	X	X	X
14	7631-2013T10100001	X	X	X
	Total	4	14	7

(U) Source: DoD OIG, based on DCAA and DCMA data.

(U) Management Comments

(U) Defense Contract Management Agency Director



DEFENSE CONTRACT MANAGEMENT AGENCY

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

JAN 29 2021

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: DCMA Management Comments DoDIG Draft "Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors," December 17, 2020 (Project D2019-DEVOSO-174.000)

Attached are DCMA's Management Comments to the subject Draft Report. (TAB A).

The point of contact for this response is [REDACTED]

A handwritten signature in black ink, appearing to read "D. Bassett", is positioned above the printed name of the Director.

David G. Bassett
LTG, USA
Director

Attachment(s):

TAB A DCMA's Management Comments

Link(s):

None

(U) Defense Contract Management Agency Director (cont'd)

DCMA Response on Draft Report for Project D2019-DEV0SO-174.000, "Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors," December 17, 2020

Recommendation 1

We recommend that the Defense Contract Management Agency Director take the following steps for the eight audit reports listed in Appendix B for which the contracting officer did not adequately document or adequately explain the reason for disagreeing with the Defense Contract Audit Agency:

- a. Reopen the audit report in the Contract Audit Follow-up System until all findings are settled.**
- b. Review the contracting officers' decision to not uphold the Defense Contract Audit Agency findings and recommendations and determine whether the costs are unallowable in accordance with the Federal Acquisition Regulation.**
- c. Disallow and recoup any unallowable costs not previously disallowed.**

This draft DODIG audit report asserts that, for eight (8) Defense Contract Audit Agency (DCAA) audit reports, DCMA lacked adequate documentation and rationale for disagreeing with DCAA audit finding recommendations. DCMA believes it has additional documentation in its files to support many of these determinations. After receiving the draft report, DCMA requested a list of the specific documentation the Inspector General (DoDIG) believes is necessary to support the DCMA contracting officers' rationale, which DoDIG provided on January 6, 2021. DCMA is currently reviewing its files for this documentation. To the extent DCMA cannot find adequate information in its files to justify the Contracting Officer determinations, DCMA concurs with the recommendations and will:

- a. reopen the CAFU records;
- b. review the contracting officers' decisions to not uphold the DCAA findings and recommendations and determine whether the costs are unallowable in accordance with the Federal Acquisition Regulation (FAR); and
- c. coordinate with DCMA Legal to determine whether legal options exist to recoup additional funds. This includes reviewing any relevant settlement agreements, releases of claims, and the applicable statute of limitations for these records.

The estimated date of completion is Q3 FY21, with the exception of any records that are, or may be, under litigation and/or criminal investigation.

Recommendation 2

We recommend that the Defense Contract Management Agency Director remind all Defense Contract Management Agency contracting officers in writing of the requirement to issue a notice of potential Cost Accounting Standard noncompliance within 15 days of receipt of a reported Cost Accounting Standard noncompliance, in accordance with Federal Acquisition Regulation 30.605(b)(1) and Defense Contract Management Agency Instruction 108.

(U) Defense Contract Management Agency Director (cont'd)

DCMA Response on Draft Report for Project D2019-DEV0SO-174.000, "Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors," December 17, 2020

DCMA concurs with this recommendation and will communicate to the contracting workforce in writing. The DCMA Contracts Directorate will likely issue a C-Note to the DCMA contracting community reminding them of the 15 day requirement to issue potential Cost Accounting Standards (CAS) non-compliances and the importance of adhering to this deadline. Additionally, this information is socialized via DCMA Manuals 2201-04 Contract Audit Follow Up, and 2201-03 Cost Accounting Standards.

The estimated date of completion is Q3 FY21. A copy of any released communications and/or C-Notes will be provided to the DODIG.

Recommendation 3

We recommend that the Defense Contract Management Agency Director require the contracting officers for Audit Report Numbers 6631-2016C19200001 and 6631-2016C19200002 to take the following actions in accordance with Federal Acquisition Regulation 30.605 and Defense Contract Management Agency Instruction 108:

- a. Reopen the audit report in the Contract Audit Follow-up System until all findings are settled.
- b. Make a determination of Cost Accounting Standards compliance (if applicable).
- c. Based on the results of the review in Recommendation 3.b, take steps to:
 - 1. notify the contractor of the compliance determination;
 - 2. make a determination on the cost impact; and
 - 3. recoup any cost increase to the Government as a result of the noncompliances.

The draft DODIG audit report asserts that DCMA contracting officers failed to make an appropriate CAS determination with respect to two of the DCAA audits which DoDIG reviewed. DCMA believes it may have additional documentation in its files to support these determinations and is currently reviewing its files for this documentation. To the extent DCMA cannot find adequate information in its files, DCMA concurs with the recommendations and will:

- a. re-open the two CAFU records;
- b. make any outstanding CAS compliance determinations; and
- c.
 - 1. notify the contractor of the CAS non-compliance if applicable;
 - 2. determine the cost impact, if any, of any CAS non-compliance;
 - 3. seek legal guidance to determine if any of cost increases due to the Government as a result of the CAS non-compliance can be recouped.

The estimated date of completion is Q3 FY21.

(U) Defense Contract Management Agency Director (cont'd)

DCMA Response on Draft Report for Project D2019-DEV0SO-174.000, "Evaluation of Defense Contract Management Agency Actions Taken on Defense Contract Audit Agency Report Findings Involving Two of the Largest Department of Defense Contractors," December 17, 2020

Recommendation 4

We recommend that the Defense Contract Management Agency Director require the supervisors of the contracting officers for the 14 audit reports listed in Appendix C to receive training on the level of review necessary to provide an effective control for ensuring that contracting officers complete actions appropriately when addressing Defense Contract Audit Agency audit reports.

DCMA concurs with the recommendation and will provide additional training to the supervisors of the DCMA contracting officers cognizant over the cited CAFU records.

The estimated date of completion is the end of Q4 FY21.

Recommendation 5

We recommend that Defense Contract Management Agency Director implement a policy which requires contracting officers to retain key documents that support their actions on audit reports in Defense Contract Management Agency's Electronic Document Records Management System.

DCMA concurs with this recommendation. A new Records Management and Retention manual is forthcoming that will clearly indicate which records should be retained, where records should be stored, and how long they should be retained.

The estimated date of completion is Q1 FY22.

(U) Acronyms and Abbreviations

CACO	Corporate Administrative Contracting Officer
CAFU	Contract Audit Follow-up
CAS	Cost Accounting Standards
DACO	Divisional Administrative Contracting Officer
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
FAR	Federal Acquisition Regulation

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