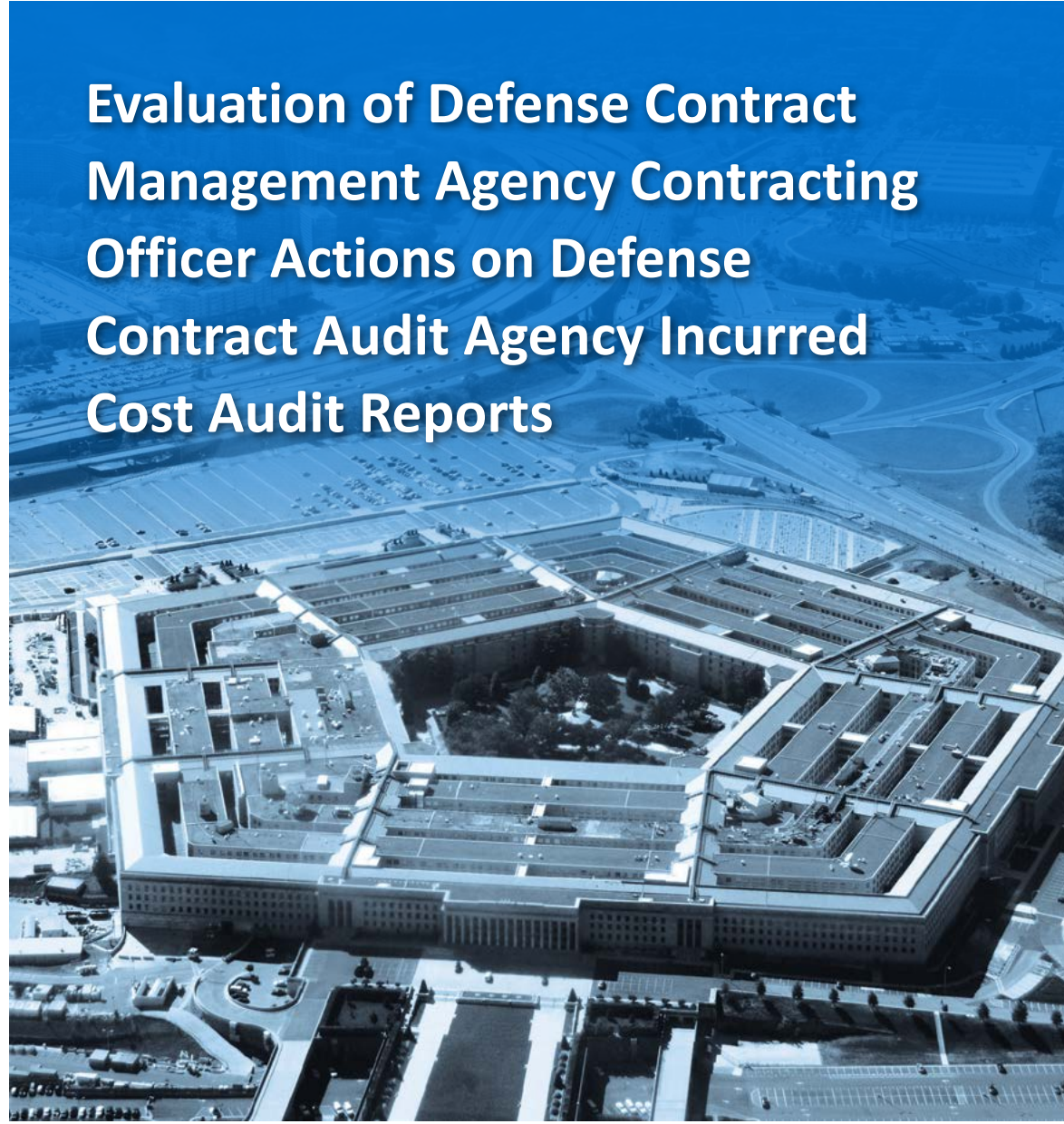




INSPECTOR GENERAL

U.S. Department of Defense

FEBRUARY 9, 2017



Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports

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Results in Brief

Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports

February 9, 2017

Objective

We evaluated the appropriateness of Defense Contract Management Agency (DCMA) actions on Defense Contract Audit Agency (DCAA) findings reported in 22 incurred cost audit reports. Specifically, we determined whether the DCMA contracting officer's actions on the 22 reports complied with applicable sections of the Federal Acquisition Regulation (FAR), DoD Instruction 7640.02, "Policy for Follow-up of Contract Audit Reports," and DCMA policy.

Findings

For the 22 incurred cost reports we selected, we found several instances when DCMA contracting officer actions did not comply with FAR, DoD Instruction 7640.02, or DCMA instructions. We found:

- eight instances when contracting officers did not address direct costs questioned by DCAA worth \$305 million;
- seven instances when DCMA did not assess or waive penalties on \$1.4 million in expressly unallowable costs, as FAR 42.709-3, "Assessing the Penalty," and FAR 42.709-5, "Waiver of the Penalty," requires;
- two instances when contracting officers failed to document adequate reasons for not upholding \$5.6 million in audit recommendations, as FAR 42.705-1(b)(5)(iii) requires;

Findings (cont'd)

- three instances when questioned costs upheld by the contracting officer totaling \$4.3 million were not incorporated in the incurred cost agreement with the DoD contractor; and
- five instances when contracting officers did not complete their actions within the resolution and disposition timeframes established in DoD Instruction 7640.02.

As a result, contracting officers may have inappropriately reimbursed DoD contractors for millions of dollars in unallowable costs, the Government did not collect penalties when they should have been assessed, or reported incurred cost findings were not addressed in a timely manner.

Finally, in 15 of 22 reports, contracting officers did not enter accurate status information in the DoD Contract Audit Follow-up (CAFU) system, which DoD Components use to track the status of actions contracting officers take on DCAA audit reports. The errors diminished the reliability of the system as a tool for monitoring contracting officer actions on incurred cost audit reports.

Recommendations

We recommend that the Director, DCMA:

- address the outstanding questioned direct costs;
- assess or waive penalties as appropriate;
- consider educational or corrective opportunities for each of the contracting officers in relation to the requirement to provide adequate reasons for not following the audit recommendations in accordance with the FAR and DoD Instruction 7640.02; and
- correct the CAFU inaccuracies.



Results in Brief

Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports

Management Comments and Our Response

The Director, DCMA, agreed with the recommendations. The comments and the planned corrective actions addressed the specifics of the recommendations, and no additional comments are required.

DCMA plans to take appropriate action to address the outstanding direct costs, reassess penalties and interest, correct inaccurate CAFU records, and provide related training to contracting officers. We request DCMA furnish the DoD Office of Inspector General with documentation supporting that the planned corrective actions have been implemented once completed.

Please see the Recommendations Table on the next page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Contract Management Agency		A.1.a, A.1.b, A.2.a, A.2.b, B.1.a, B.1.b, B.1.c, C.1, C.2.a, C.2.b, C.2.c, D.1.a, D.1.b, D.1.c, D.2, E.1.a, E.1.b, E.1.c, E.1.d, E.2.a, E.2.b





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

February 9, 2017

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Evaluation of Defense Contract Management Agency Contracting Officer Actions
on Defense Contract Audit Agency Incurred Cost Audit Reports
(Report No. DODIG-2017-055)

We are providing this report for your information and use. We evaluated the appropriateness of Defense Contract Management Agency (DCMA) contracting officer actions to resolve and disposition Defense Contract Audit Agency incurred cost audit report findings. We found several instances when DCMA contracting officers did not comply with the Federal Acquisition Regulation and DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports." We conducted this evaluation in accordance with the "Quality Standards for Inspections and Evaluations," published in January 2012 by the Council of the Inspectors General on Integrity and Efficiency.

We considered management comments on a draft of this report when preparing the final report. Comments from the Director, Defense Contract Management Agency, conform to the requirements of DoD Instruction 7650.03; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to Mrs. Carolyn R. Hantz at (703) 604-8877 (DSN 664-8877) or by e-mail Carolyn.Hantz@dodig.mil.

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

Randolph R. Stone
Deputy Inspector General
Policy and Oversight

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Introduction

Objective

We evaluated Defense Contract Management Agency (DCMA) contracting officer actions on Defense Contract Audit Agency (DCAA) incurred cost audit reports for compliance with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy.

Our evaluation included a review of the actions that DCMA contracting officers took on 22 incurred cost audit reports issued by DCAA between September 2013 and July 2015. See Appendix A for a discussion of our scope and methodology.

Background

Defense Contract Audit Agency

DCAA performs contract audits for the DoD and operates in accordance with DoD Directive 5105.36, "Defense Contract Audit Agency," January 4, 2010. DCAA reports to the Under Secretary of Defense (Comptroller)/Chief Financial Officer. DCAA performs several types of contract audits, including audits of DoD contractor-claimed costs incurred on Government contracts.

FAR Clause 52.216-7, "Allowable Cost and Payment," requires contractors to submit an adequate indirect cost rate proposal within six months following the close of the contractor's fiscal year. The contractor submits the proposal to claim actual indirect costs incurred on Government contracts, and to reconcile them to amounts previously billed. DCAA audits indirect cost rate proposals to determine whether the contractor's indirect costs claimed on Government contracts are allowable, allocable, and reasonable based on applicable criteria in the FAR, Defense Federal Acquisition Regulation Supplement, Cost Accounting Standards, and contract terms.

Defense Contract Management Agency

DCMA is a DoD Component that works directly with DoD contractors to ensure Government supplies and services are delivered on time and at projected cost. In its role as the contract administration office outlined in FAR 42.3, "Contract Administration Office Functions," DCMA is responsible for several contract administrative functions such as approving or disapproving contractor business systems, evaluating contractor compliance with the Cost Accounting Standards, and establishing final indirect cost rates. In most instances, DCMA contracting officers take action on DCAA incurred cost audit reports as part of their establishment of

final indirect cost rates. In 2015, DCMA contracting officers completed actions on 548 DCAA incurred cost audit reports, upholding \$858 million of \$2.9 billion (approximately 29 percent) in costs questioned by DCAA. On average, DCMA has upheld approximately 40 percent of DCAA questioned costs in the last 5 years.

Department of Defense Instruction 7640.02

DoD Instruction 7640.02, “Policy for Follow-up on Contract Audit Reports,” April 15, 2015,¹ establishes policy, assigns responsibilities, and provides direction for reporting requirements and follow-up procedures on DCAA audit reports, including incurred cost audit reports. The Instruction requires that contracting officers resolve a DCAA audit report within 6 months and disposition it within 12 months. An audit report is generally considered resolved when the contracting officer has documented an action plan for addressing the reported findings in a pre-negotiation objective memorandum (PNOM) in accordance with FAR 42.705-1(b)(5)(iii). The audit report is generally considered dispositioned when the contracting officer has prepared a signed and dated post-negotiation memorandum (PNM)² and executes any required contractual action (such as an indirect cost rate agreement³).

The Instruction requires contracting officers to maintain accurate records of actions they take to resolve and disposition audit findings and recommendations. The Instruction also requires all DoD Components to submit semiannual status reports on contract audits to the DoD Office of Inspector General (OIG). The DoD OIG includes a summary of the status reports in the Semiannual Report to Congress.

¹ The August 22, 2008, version of DoD Instruction 7640.02 applies to some contracting officer actions taken on the audit reports we selected for evaluation. However, except where otherwise stated, the current April 15, 2015, version of DoD Instruction 7640.02 is consistent with the August 22, 2008, version for all significant matters discussed in this report.

² A PNM refers to the contracting officer’s documented results of negotiation on audit findings and any other issues subject to negotiation.

³ An indirect cost rate agreement refers to a written understanding between the contractor and the Government on indirect rates that the Government uses to close out cost-reimbursement contracts.

Finding A

Need for Contracting Officers to Address Questioned Direct Costs

In 8 of 22 reports we selected, contracting officers have not taken action on DCAA questioned direct costs even though the DCAA reports were issued more than 2 years ago on average. The questioned direct costs in the eight reports total \$305 million. The failure to take action on the questioned direct costs does not comply with DoD Instruction 7640.02, “Policy for Follow-up on Contract Audit Reports.” Appropriately addressing questioned direct costs in a timely manner is important for ensuring that the Government does not pay the contractor for costs that are unallowable.

Requirements for Taking Action on Questioned Costs

DoD Instruction 7640.02, Enclosure 3, states that contracting officers must:

- address all audit findings and recommendations and complete the PNM before reporting the audit as dispositioned in Contract Audit Follow-up (CAFU) system;
- coordinate with other Government agencies that have responsibility for resolving a portion of the audit findings and recommendations; and
- incorporate the negotiation results from other Government agencies in the PNM, if applicable.

DCMA Instructions 125 and 126 implement DoD Instruction 7640.02.

DCMA Instruction 126 requires the DCMA contracting officer to indicate in the PNM whether the audit finding or recommendation is agreed to and, if not, include sound rationale and basis for the disagreement.

Need to Settle Questioned Direct Costs

Of the 22 DCAA reports we selected, 12 reports included questioned direct costs charged on DoD contracts. For 8 of the 12 reports, contracting officers took no action on questioned direct costs worth \$305 million, as DoD Instruction 7640.02 and DCMA instructions require. The questioned direct costs have been pending action by the contracting officer for more than 2 years on average. Table 1 shows the amount of questioned direct costs by audit report that contracting officers have not addressed.

Table 1. Questioned Direct Costs Not Addressed

Audit Report Number	Questioned Direct Costs Not Addressed	Authority to Negotiate Questioned Direct Costs
3321-2009K10100002	\$158,812,697	DCMA
6281-2005G10100001	30,440,065	DCMA
4531-2007K10100001	2,385,825	DCMA
3161-2007F10100001	4,922,064	DCMA
6271-2003A10100103	98,167,148	DCMA
1311-2006C10100006	2,900,992	DCMA
Total DCMA	\$297,628,791	6
2161-2007T10100001	3,052,934	Multiple DoD Components
3181-2009D10100001	4,163,301	Multiple DoD Components
Total Multiple DoD Components	\$7,216,235	2
Total	\$304,845,026	8

For the first six listed reports, DCMA contracting officers had the authority to negotiate the questioned direct costs. The contracting officers could not explain why they took no action on the questioned direct costs in accordance with their negotiation authority. For one of the six reports (DCAA Audit Report No. 1311-2006C10100006), the DCMA contracting officer explained that he did not address the questioned direct costs because he believed the Contract Disputes Act's 6-year statute of limitations⁴ on the contracts had expired. However, the contracting officer's own legal counsel advised the contracting officer that the statute of limitations does not preclude the contracting officer from pursuing the questioned direct costs. The legal counsel also advised that the statute may not have expired because the contractor had submitted revised incurred cost proposals to the Government. Nevertheless, we noted that the same contracting officer successfully negotiated and upheld \$90,625 of the \$141,725 in reported questioned indirect costs more than 6 years after the same contractor submitted its initial indirect cost proposal.

For the remaining two reports, multiple DoD Components have negotiation responsibility for the questioned direct costs. However, according to DoD Instruction 7640.02, the DCMA contracting officer is responsible for coordinating the questioned direct costs with the other DoD Components and incorporating the negotiation results into the PNM. The two DCMA contracting officers could not demonstrate they had appropriately coordinated with the other DoD Component contracting officers for settlement of the questioned direct costs.

⁴ The Contract Disputes Act (41 U.S.C. 7101-7109) imposes a 6-year statute of limitations on all claims, whether they are asserted by the contractor or by the Government. The statute period begins upon the accrual of a claim, which is the date when all events that fix the alleged liability of either the Government or the contractor and permit assertion of the claim were known or should have been known.

Management Actions on Prior Recommendations

In Report No. DODIG-2016-091, "Evaluation of the Accuracy of Data in the DoD Contract Audit Follow-Up System," May 13, 2016, we reported that DCMA contracting officers were not completing all required actions on DCAA findings (including questioned direct costs) before recording the DCAA report as dispositioned in the CAFU system. As a result of that report, DCMA hosted an August 10, 2016, summit with DoD Components to explore the best options for assigning responsibility of questioned direct costs. Summit attendees identified various options for addressing questioned direct costs and DCMA is carefully considering them. In addition, a conference attendee stated that Defense Procurement Acquisition Policy will be involved in advancing the discussion of this issue on behalf of the DoD.

Because DCMA is in the process of taking corrective action to improve its controls for responding to questioned direct costs, we have no additional recommendations for DCMA to improve related controls at this time.

Conclusion

In eight instances, contracting officers took no action on DCAA reported questioned direct costs. Until action is taken, the Government is at risk of overpaying DoD contractors by up to \$305 million. Timely action is critical for recouping any unallowable cost and protecting the Government's interests. Resolution of the questioned direct costs becomes more difficult over time because individuals having a detailed knowledge of the issues may transfer or retire, or the records may become lost.

Accordingly, DCMA needs to assess the eight cases and take appropriate steps to address the questioned direct costs in compliance with DoD Instruction 7640.02 and DCMA Instructions 125 and 126.

Recommendations, Management Comments, and Our Response

Recommendation A.1

We recommend that the Director, Defense Contract Management Agency request the six Defense Contract Management Agency contracting officers with negotiation authority to:

- a. Take appropriate action on the Defense Contract Audit Agency reported questioned direct costs of \$297.6 million and
- b. Document the action in a post-negotiation memorandum, as DoD Instruction 7640.02 requires.

Recommendation A.2

We recommend that the Director, Defense Contract Management Agency direct the two remaining Defense Contract Management Agency contracting officers to:

- a. Coordinate with the other DoD Component contracting officers having authority to negotiate the reported questioned direct costs of \$7.2 million and
- b. Incorporate the negotiation results from the other DoD Components in a post-negotiation memorandum, as DoD Instruction 7640.02 requires.

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed and stated that DCMA will request the contracting officers to reopen audit assignments and take appropriate actions, including coordination with component contracting officers. In addition, contracting officers will document the actions they take in a PNM reviewed by management. DCMA will complete the actions by May 2017.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request DCMA furnish the DoD OIG with documentation (including the PNM) supporting that the contracting officers have taken appropriate actions on the questioned direct costs.

Finding B

DCMA Needs to Assess Penalties on Expressly Unallowable Cost

In 7 of 22 instances, DCMA contracting officers did not comply with FAR 42.709-3, “Assessing the Penalty,” because the contracting officers did not assess penalties or adequately justify a waiver of penalties on \$1.4 million in costs DCAA reported as expressly unallowable (also referred to as “questioned costs subject to penalty”). As a result, the Government did not recoup up to \$1.4 million in penalties associated with the contractors’ failure to exclude expressly unallowable costs in its incurred cost proposals. The failure of contracting officers to consistently apply 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.

Requirement for Assessing Penalties

Contractors certify that incurred cost proposals submitted to the Government exclude costs identified as expressly unallowable in the FAR.

FAR 42.709, “Scope,” implements section 2324(a) through (d), title 10, United States Code (10 U.S.C. § 2324), which cover the assessment of penalties against contractors that include expressly unallowable indirect costs in incurred cost proposals.

FAR 42.709-3, “Assessing the Penalty,” states that unless the contracting officer grants a waiver pursuant to FAR 42.709-5, “Waiver of the Penalty,” the contracting officer shall assess penalties when a contractor submits an incurred cost proposal with costs that are expressly unallowable under FAR or the contract terms. In most cases, the penalty is equal to the amount of expressly unallowable costs included in the incurred cost proposal. Interest is also charged on payments made to the contractor for expressly unallowable costs.

FAR 42.709-5 requires that the contracting officer waive penalties under specific conditions. For example, the contracting officer must waive penalties when the contractor withdraws its indirect cost rate proposal before the Government initiates an audit of the proposal and the contractor submits a revised proposal.

DCMA Instruction 125 implements FAR 42.709. The Instruction states that the contracting officer must document sound rationale when considering whether to assess or waive penalties. It also requires DCMA management to verify that contracting officers have complied with DCMA Instruction 126.

DCMA Actions on Expressly Unallowable Costs

In 20 of 22 reports, DCAA recommended the application of penalties for expressly unallowable costs included in DoD contractor incurred cost proposals. For the seven reports listed in Table 2, contracting officers sustained (upheld) \$1.4 million in DCAA reported expressly unallowable costs, but they did not assess penalties in accordance with FAR 42.709-3 or adequately justify a waiver of penalties in accordance with FAR 42.709-5.

Table 2. Sustained Questioned Cost Subject to Penalties

DCAA Report No.	Sustained Expressly Unallowable Costs Subject to Penalties	No Penalties or Interest Assessed	Penalties Waived
6271-2003A10100103	\$26,500	X	
6741-2008Q10100003	350,778	X	
1311-2006C10100006	106,931	X	X
2421-2007P10100002	84,413	X	X
3151-2007E10100597	27,026	X	X
1241-2008S10100001)	733,882	X	X
3161-2007F10100001	70,878	X	X
Total	\$1,400,408	7	5

In five of seven instances, contracting officers waived the penalties but the justification for waiving them was not consistent with one of the conditions cited in FAR 42.709-5.

The types of expressly unallowable costs for which the contracting officers did not assess penalties included:

- lobbying and political activities,
- entertainment costs,
- fines and penalties,
- alcoholic beverages,
- legal and other proceedings, and
- travel exceeding maximum per diem rates.

In all seven instances, the contracting officers obtained management approval of their actions on the DCAA audit reports (to include 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 the FAR 42.709 requirements.

DCMA should improve its management review of contracting officer actions to better ensure that contracting officers assess penalties for expressly unallowable costs or document a waiver of penalties that complies with FAR 42.709-5.

Conclusion

In seven cases, contracting officers did not assess a penalty or adequately document a waiver of penalties, as FAR 42.709 requires. Failure to consistently assess penalties for claimed expressly unallowable costs results in the loss of funds to the DoD and diminishes the incentive of contractors to exclude expressly unallowable costs from incurred cost proposals. The assessment of penalties and interest serves as an important incentive for contractors to exclude unallowable costs from incurred cost proposals.

DCMA should assess penalties and interest on the seven cases or, if appropriate, grant a waiver in accordance with FAR 42.709-5.

Recommendations, Management Comments, and Our Response

Recommendation B.1

We recommend that the Director, Defense Contract Management Agency:

- a. Request that the cognizant contracting officers assess penalties (including interest) or, if appropriate, waive them in accordance with Federal Acquisition Regulation 42.709 for the sustained questioned costs reported as expressly unallowable in the seven Defense Contract Audit Agency reports.**

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed to take the recommended action after the contracting officers review the seven cases to determine if the questioned costs are expressly unallowable and penalties should be pursued. DCMA plans to complete the recommended action by May 2017.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request that DCMA furnish the DoD OIG with documentation supporting the contracting officers' determination as to whether the questioned costs are allowable and if penalties should be pursued.

- b. Consider educational or corrective opportunities for each of the contracting officers that did not assess penalties or appropriately waive them to ensure the contracting officers are aware of their responsibilities for complying with Federal Acquisition Regulation 42.709.**

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed to consider additional educational opportunities for the contracting officers. In addition, DCMA will incorporate the topic of penalties and interest in its CAFU training for incurred cost audits. DCMA plans to provide the training in March and April of 2017.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request DCMA furnish the DoD OIG with documentation supporting that additional educational opportunities were considered, and that training was provided to contracting officers on the topic of penalties and interest.

- c. Improve the management review of contracting officer actions to better ensure contracting officers assess penalties for expressly unallowable costs or document a waiver of penalties that complies with Federal Acquisition Regulation 42.709-5.**

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed, stating that the training being provided in March and April of 2017 will emphasize the management review of all items addressed in negotiation memorandums. DCMA noted that DCMA Instructions 125 and 126 cover the management review requirements of the entire negotiation process.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request DCMA furnish the DoD OIG with documentation supporting that the Agency provided training to contracting officers on the management review of all items addressed in negotiation memorandums.

Finding C

Negotiation Memorandum and Indirect Rate Letter Inadequacies

For 2 of 22 reports, contracting officers did not prepare negotiation memorandums that complied with FAR 42.705-1(b)(5)(iii). The contracting officers did not adequately explain why they disagreed with audit findings involving \$5.6 million in questioned costs.

For 3 of 22 reports, the indirect cost rate agreement did not incorporate all questioned costs that the contracting officer upheld according to the negotiation memorandum. In total, the three indirect cost rate agreements did not incorporate \$4.3 million in questioned costs that were upheld by the contracting officer.

As a result of the negotiation memorandum and indirect cost rate agreement inaccuracies, contracting officers may have reimbursed DoD contractors millions of dollars in unallowable costs that cannot be recouped.

Finally, in 8 of 22 instances, contracting officers could not demonstrate that they had provided the negotiation memorandum or indirect cost rate agreement to agencies affected by the negotiation, as FAR 42.706, "Distribution of Documents," requires.

Requirements for Preparing a Negotiation Memorandum and Indirect Rate Agreement

When establishing indirect cost rates, FAR 42.705-1, "Contracting Officer Determination Procedure," and DoD Instruction 7640.02, Enclosure 3, require that contracting officers prepare a negotiation memorandum that includes:

- the disposition of significant matters in the audit report;
- a reconciliation of all costs questioned, with identification of items and amounts allowed or disallowed in the final settlement; and
- reasons why any of the audit findings were not upheld.

The negotiation memorandum is used to determine final allowable costs and to close contracts.

According to FAR 42.705-1(b)(5)(ii), the contracting officer must prepare a written indirect cost rate agreement, which serves as the negotiated final settlement between the Government and the DoD contractor for indirect cost rates used on

Government flexibly-priced contracts. The agreement must exclude any DCAA questioned costs that the contracting officer upholds in negotiations with the contractor, according to the negotiation memorandum.

Inadequate Negotiation Memorandums

In 2 of 22 instances, contracting officers did not prepare negotiation memorandums that complied with FAR 42.705-1. Most importantly, the memorandums failed to adequately document the reasons why the audit findings, worth a combined \$5.6 million, were not upheld. The contracting officers did not justify the actions they took on the audit reports and, as a result, they may have inappropriately reimbursed DoD contractors for millions of dollars in unallowable costs.

Furthermore, the Government may be prevented from recovering any unallowable costs because the contracting officers signed binding contractual agreements with the DoD contractors, which allowed reimbursement of the costs. Discussed below are details concerning the memorandums for each audit report.

DCAA Audit Report No. 4301-2008F10100001

The DCAA audit report questioned \$2,346,856 of direct and indirect contract labor because the contractor did not adequately support the costs or follow contract terms. For example, DCAA found instances where the contractor made payments to vendors that exceeded the contract terms. In DCMA's June 5, 2015, draft negotiation memorandum (also known as the pre-negotiation memorandum), the contracting officer and a DCMA cost analyst concurred with DCAA and planned to uphold all DCAA questioned costs.

In DCMA's June 29, 2015, final negotiation memorandum (also known as the post-negotiation memorandum), the cost analyst again recommended that the contracting officer uphold all DCAA questioned costs. However, the contracting officer decided to uphold only \$63,988 of the \$2,346,856 in DCAA questioned costs. The contracting officer upheld only a small portion (2.7 percent) of the questioned direct labor and indirect costs.

The contracting officer failed to adequately document why she did not uphold the remaining \$2,282,868 in DCAA questioned labor costs as she initially planned and as the DCMA cost analyst had recommended. The contracting officer did not explain in the final negotiation memorandum why she only upheld \$63,988. The contracting officer has since resigned from DCMA. Neither the DCMA cost analyst nor the DCMA management team that reviewed and approved the PNM could explain the contracting officer's actions.

DCAA Audit Report No. 6271-2003A10100103

The DCAA audit report questioned \$3,299,456 in indirect costs based on noncompliances with the FAR and inadequate support provided by the contractor. The contracting officer did not uphold any of the questioned costs. The negotiation memorandum prepared by the contracting officer was inadequate for the following reasons.

- The memorandum states that the DCAA questioned costs were allowed in part because the contracting officer believed the statute of limitations had passed. Although the statute of limitations may have passed, the contracting officer received legal guidance stating that contracting officers should nevertheless proceed with negotiating a settlement of the questioned costs.
- The contracting officer did not document any rationale for disagreeing with the auditor's finding that the questioned costs were in noncompliance with the FAR.
- The memorandum states that the contracting officer reviewed supplemental documentation as rationale for reimbursing the DCAA questioned costs. However, the PNM does not identify or describe the documentation relied upon in reaching the settlement, as DoD Instruction 7640.02, Enclosure 3, paragraph 3.b, requires.
- The contracting officer did not obtain the contract auditor's opinion on the allowability of the costs after reviewing the supplemental documentation, as FAR 42.705-1(b)(4)(i) and DCMA Instruction 125, require.
- The memorandum does not document a reconciliation of all costs questioned in the audit report, as FAR 42.705-1(b)(5)(iii)(B) requires.

Therefore, the contracting officer's negotiation memorandum did not comply with requirements of FAR 42.705-1(b)(5)(iii) for preparing a negotiation memorandum. The contracting officer expressed to us that she negotiated a fair and reasonable settlement with the contractor, especially considering that the statute of limitations may have expired. The contracting officer also emphasized the contractor's willingness to negotiate with the Government despite the statute of limitations. However, in accordance with the FAR and the legal guidance she received, the contracting officer was obligated to adequately document her reasons for disagreeing with the auditor on the allowability of \$3,299,456 in indirect costs.

Indirect Cost Rate Agreement Inconsistencies

For 3 of 22 reports, we found inconsistencies between the negotiation memorandum and corresponding indirect cost rate agreement. Specifically, as shown in Table 3, the indirect cost rate agreements did not exclude \$4.3 million in costs that contracting officers had upheld in negotiations with the contractor according to the negotiation memorandum.

Table 3. Differences between Negotiation Memorandums and Indirect Cost Rate Agreements

DCAA Audit Report Number	Questioned Costs Upheld in the Negotiation Memorandum	Questioned Costs Excluded from the Indirect Cost Rate Agreement	Difference
3151-2007E10100597	\$12,724,687	\$9,111,188	\$3,613,499
3161-2007F10100001	3,882,411	3,333,214	549,197
3151-2008E10100104	139,181		139,181
Total	\$16,746,279	\$12,444,402	\$4,301,877

For Audit Report Nos. 3151-2007E10100597 and 3161-2007F10100001, the contracting officers responsible for preparing the negotiation memorandum and the indirect cost rate agreement were unable to adequately explain the difference. For Audit Report No. 3151-2008E10100104, the responsible contracting officer explained that the difference resulted from an inadvertent error.

The accuracy and completeness of the negotiation memorandum and indirect cost rate agreement is an important part of the contract administration process. They serve as the primary means of documenting that the contracting officer's actions were consistent with applicable laws and regulations. The documents also serve to protect the Government's interests in the event of future disputes. The indirect cost rate agreement, which is prepared annually, establishes the indirect cost rates that the contractor will use to bill the Government and close contracts. Once signed, the indirect cost rate agreement is a binding contractual document. As a result, the Government may be prevented from recovering any difference between the two documents involving costs that the Government and the contractor agreed are unallowable.

Negotiation Documents Not Distributed to DCAA and Other Government Agencies

FAR 42.706 requires that contracting officers distribute a copy of the negotiation memorandum and the indirect cost rate agreement to Government agencies involved in, or affected by, the negotiation. Affected Government agencies use these documents to determine final allowable costs on Government contracts.

DoD Instruction 7640.02, Enclosure 3, paragraph 3.c, also requires that the contracting officer distribute the negotiation memorandum and indirect cost rate agreement to DCAA. DCMA Instruction 125 states that the contracting officer must document the date and method of transmittal of the negotiation memorandum to DCAA.

For the 22 audits, we looked through DCMA's contract files to determine if the files included evidence that contracting officers had distributed copies of the negotiation memorandum and indirect cost rate agreement to DCAA and other affected contracting officers, as FAR and the DoD Instruction requires. In 8 of the 22 cases, the contract files do not document the date or transmittal method of the documents. In all 8 cases, the contracting officers were aware of the requirement to distribute the documents, and believe they had actually distributed the documents as required. However, the contracting officers acknowledged that they did not retain a record of the distribution in the contract file. Without a record of distribution, the contracting officers could not demonstrate that the documents were actually sent to DCAA and affected agencies.

Appropriately distributing the negotiation memorandum and indirect cost rate agreement to DCAA and other Government agencies is essential for ensuring that the negotiation results are incorporated in affected contracts. The memorandum and agreement are also required to reconcile contractor billings and to close completed contracts. DCMA should implement a control to help ensure that negotiation documents are distributed in accordance with FAR 42.706 and evidence of the distribution is maintained in the DCMA contract file.

Conclusion

For 2 of 22 audit reports, DCMA contracting officers failed to document sufficient rationale for not upholding DCAA questioned costs worth a combined total of \$5,582,324, as FAR 42.705-1 and DoD Instruction 7640.02 require.

In three instances, we found \$4.3 million in differences between the negotiation memorandum and the indirect cost rate agreement.

Finally, in eight instances, DCMA contract files did not include confirmation that contracting officers had distributed the negotiation memorandum or the indirect cost rate agreement, as FAR 42.706 and DoD Instruction 7640.02 require.

The DCMA contracting officers' failure to prepare and distribute adequate and accurate negotiation documents could result in the closure of Government contracts without excluding the payment of unallowable costs to DoD contractors.

Recommendations, Management Comments, and Our Response

Recommendation C.1

We recommend that the Director, Defense Contract Management Agency improve controls for ensuring the completeness and accuracy of negotiation documents in accordance with Federal Acquisition Regulation 42.705-1(b)(5), DoD Instruction 7640.02, and the Defense Contract Management Agency Instruction 125.

Recommendation C.2

We recommend that the Director, Defense Contract Management Agency provide refresher training to the contracting officers emphasizing DoD Instruction 7640.02, Defense Contract Management Agency Instruction requirements to:

- a. Address and document all audit findings, including any questioned direct costs, on the negotiation memorandum.**
- b. Maintain evidence demonstrating that the contracting officer appropriately distributed negotiation documents, including the indirect cost rate agreement and negotiation memorandum.**
- c. Consider additional educational or corrective opportunities for those contracting officers that did not prepare adequate negotiation documents or distribute them in accordance with Federal Acquisition Regulation 42.706.**

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed with the recommendations. According to DCMA, the key control is supervisory review and approval. To enhance the control's effectiveness, DCMA will provide training that includes a discussion of what went wrong with the cases addressed in this report. Also, the training will emphasize the importance of maintaining adequate documentation to support decisions and the requirement to document the decisions in negotiation documents and related correspondence. In addition, the training will cover the additional requirement to properly distribute the negotiation results.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request DCMA furnish the DoD OIG with documentation supporting that the Agency provided training to contracting officers on 1) what went wrong with the cases discussed in this report, and 2) the importance of maintaining adequate documentation.

Finding D

Untimely Resolution and Disposition of DCAA Incurred Cost Audit Reports

For 5 of 22 reports, DCMA contracting officers did not complete their actions within the 6-month resolution timeframe or the 12-month disposition timeframe established in DoD Instruction 7640.02. Timely resolution and disposition of audit findings helps to ensure that the contractor corrects the reported noncompliance in a timely manner and the Government promptly recoups unallowable costs, penalties, and interest.

Requirement for Taking Action on Audit Reports in a Timely Manner

DoD Instruction 7640.02, Enclosure 3, paragraph 3, and DCMA Instruction 126 require DCMA contracting officers to resolve DCAA audit findings within 6 months and disposition them within 12 months. If audit findings are not resolved or dispositioned within the timeframes, contracting officers must document, at least monthly, the actions they take to achieve resolution or disposition.

Untimely Resolution and Disposition

In 4 of 22 instances, DCMA contracting officers exceeded the 6-month timeframe for resolving audit reports. On average, the four contracting officers exceeded the resolution timeframe by 8 months. In 3 of 22 instances, DCMA contracting officers exceeded the 12-month disposition timeframe. On average, the 3 contracting officers exceeded the disposition timeframe by an average of 23 months. Table 4 lists the instances in which contracting officers did not achieve the established timeframes.

Table 4. Actions Exceeding the Resolution and Disposition Timeframes

Audit Report Number	Audit Report Date	Months Past the 6-Month Resolution Timeframe	Months Past the 12-Month Disposition Timeframes (as of 9/30/2016)
6741-2008Q10100003	08/07/2014	3	-
6281-2005G10100001	04/15/2013	16	30
3321-2009K10100002	05/28/2013	10	28
1241-2008S10100001	02/26/2014	2	-
4531-2007K10100001	09/29/2014	-	12

The contracting officers did not document a reason for the delays or the actions they took to achieve resolution and disposition, as DoD Instruction 7640.02 requires.

As of September 30, 2016, contracting officers have not yet dispositioned three of the audit reports (Audit Report Nos. 6281-2005G10100001, 3321-2009K10100002, and 4531-2007K10100001). The contracting officers assigned to the three reports need to determine the additional actions they should take to appropriately disposition the audit findings and document monthly the actions they take until disposition occurs.

Conclusion

In four instances, DCMA contracting officers exceeded the 6-month resolution timeframe and, in three instances, contracting officer exceeded the 12-month disposition timeframes. Contracting officers did not document the reason for the delay or the actions they took to achieve resolution or disposition, as DoD Instruction 7640.02 requires. Timely resolution and disposition of DCAA audit findings helps to ensure that the Government recoups any unallowable costs in a timely manner and that the contractor implements any required corrective actions.

Recommendations, Management Comments, and Our Response

Recommendation D.1

We recommend that the Director, Defense Contract Management Agency request that the contracting officers assigned to Audit Report Numbers 6281-2005G10100001, 3321-2009K10100002 and 4531-2007K10100001:

- a. Determine the actions they should take to appropriately disposition the audit findings;**
- b. Document the actions taken to achieve disposition at least monthly; and**
- c. Document the disposition of the audit findings in a negotiation memorandum.**

Recommendation D.2

Provide refresher training emphasizing the requirement for the Defense Contract Management Agency contracting officers to adequately update the contract audit follow-up record on a monthly basis with the cause for the delay and actions taken to achieve a timely resolution or disposition.

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed and stated that DCMA will require the contracting officers and their managers to properly disposition the audit reports and document the actions. In addition, the training that DCMA is providing in March and April of 2017 will emphasize the contracting officer's responsibility to update the CAFU record on a monthly basis and to document the actions taken.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request that DCMA furnish the DoD OIG with documentation which supports the following actions have been taken:

- The Agency required contracting officers to properly disposition the audit reports.
- The contracting officers documented their actions.
- The Agency furnished training to contracting officers emphasizing their responsibility to update and document CAFU records.

Finding E

Inaccurate Contract Audit Follow-Up Records

For 15 of the 22 reports, contracting officers entered incorrect information in one or more data fields within the CAFU system.

The accuracy of the CAFU system is important because DoD Component management and the DoD OIG use it to monitor the status of contracting officer actions taken on DCAA audit reports across the DoD. Errors within the CAFU system diminish the effectiveness of it as a tool for monitoring contracting officer actions on incurred cost audit reports. DoD OIG uses the information in the CAFU system to report to Congress the status of actions taken on DCAA findings.

Data Accuracy Requirements

DoD Instruction 7640.02 establishes recordkeeping and reporting requirements for reportable⁵ contract audit reports, including DCAA incurred cost audit reports. In support of the recordkeeping requirements, DCMA maintains an automated database referred to as “the CAFU system” that DoD Components use to track and record actions taken to resolve and disposition contract audits. Each record in CAFU represents a DCAA audit report.

Contracting officers must promptly update the status of their actions on each record assigned to them in the CAFU system. For example, when a contracting officer achieves the disposition of an audit report, they must promptly and accurately enter in CAFU the amount of questioned costs they upheld and the date they completed the disposition.

CAFU is an important tool that DoD Component management and the DoD OIG use to monitor the status of contracting officer actions taken on DCAA audit reports across the DoD. A summary of the data in CAFU is also included in the DoD OIG Semiannual Report to Congress.

Inaccurate Contract Audit Follow-Up Data

We evaluated the accuracy of the CAFU records associated with the 22 audits we selected for evaluation. A CAFU record includes approximately 20 data fields. We focused our evaluation only on the following three data fields that contracting officers must update as they take action on audit reports.

⁵ 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.

- Questioned Cost Sustained (upheld)
- Resolution Date
- Disposition Date

Of the 22 CAFU records, 15 had errors in at least 1 of the 3 data fields. In total, we found 24 data field errors. Table 5 depicts the number of errors we found within the three data fields we tested (see Appendix C for details by audit report).

Table 5. CAFU Errors by Data Field

CAFU Data Field	CAFU Records Tested	CAFU Records With Errors	Error Rate
Questioned Cost Sustained	22	4	18%
Resolution Date	22	8	36%
Disposition Date	22	12	55%
Total Errors		24	

Questioned Cost Sustained

This data field reflects the questioned amounts that the contractor agreed to during the course of the audit and those resulting from a contracting officer's final decision. Contracting officers enter this amount in CAFU after completing all necessary actions on the audit report. Of the 22 questioned cost sustained fields we tested, 4 had errors that resulted in CAFU overstating questioned cost sustained by \$8.4 million. The errors occurred because DCMA contracting officers did not comply with DoD Instruction 7640.02 for the following reasons.

- In one instance, the contracting officer input the questioned costs subject to penalty amount in CAFU instead of the questioned cost sustained amount.
- In one instance, the contracting officer incorrectly included the contractor's voluntary adjustments to its incurred cost rate proposal. The contracting officer should have excluded the adjustments because they were not a part of the DCAA questioned costs.
- In two instances, for unknown reasons, the contracting officer entered an amount in CAFU that was inconsistent with the questioned costs actually upheld and documented in the negotiation memorandum.

Resolution and Disposition Dates

Of the 22 records we evaluated, DCMA contracting officers entered 8 inaccurate resolution dates and 12 inaccurate disposition dates. We noted the following reasons for the errors.

- Thirteen errors occurred when the DCMA contracting officer entered resolution or disposition dates that were inconsistent with the negotiation memorandum. The resolution dates were inaccurate by an average of 71 days, and the disposition dates were inaccurate by an average of 13 days.
- Two errors occurred when DCMA contracting officers failed to place the CAFU records in the Defer status as a result of the issues being litigated before the U.S. Court of Federal Claims or Armed Services Board of Contract Appeals. The contracting officers assigned to the audits should remove the disposition date and reinstate the records in Defer status.
- Five errors resulted from DCMA contracting officers entering resolution or disposition dates without completing all required actions. For example, contracting officers entered a disposition date but did not take action on \$112 million in questioned direct cost. During our evaluation, the contracting officer for one the audits (Audit Report No. 4531-2007K10100001) appropriately removed the disposition date in CAFU and reopened it as unresolved. The contracting officers for the remaining four CAFU records should remove the resolution and disposition dates and reinstate the records as unresolved.

Conclusion

Of the 22 CAFU records we evaluated, 15 had errors within the 3 data fields we tested. The errors impact:

- the reliability of CAFU as a tool for documenting and monitoring contracting officer actions on DCAA audit findings;
- the Government recouping any unallowable cost paid to the contractor in a timely manner; and
- the accuracy of CAFU information reported in the DoD OIG Semiannual Report to Congress.

Similar CAFU inaccuracies were reported in DODIG-2016-091, "Evaluation of the Accuracy of Data in the DoD Contract Audit Follow-Up System," May 13, 2016. In response to that report, DCMA agreed to conduct training by December 2016 that will include instructions for improving CAFU data accuracy. As a result, we have no additional recommendations for training.

Recommendations, Management Comments, and Our Response

Recommendation E.1

We recommend that the Director, Defense Contract Management Agency remove the disposition date entered in the Contract Audit Follow-up System for the following audit reports and reinstate the reports as unresolved until the contracting officer resolves and dispositions the questioned direct costs:

- a. Audit Report No. 2161-2007T10100001
- b. Audit Report No. 3161-2007F10100001
- c. Audit Report No. 3181-2009D10100001
- d. Audit Report No. 6271-2003A10100103

Recommendation E.2

We recommend that the Director, Defense Contract Management Agency remove the resolution date entered in the Contract Audit Follow-up System for the following audit reports and change their status to Defer while the audit issues are before the U.S. Court of Federal Claims or Armed Services Board of Contract Appeals:

- a. Audit Report No. 1271-2007D10100003
- b. Audit Report No. 2801-2008B10100101

Director, Defense Contract Management Agency, Comments

The Director, DCMA, agreed with our recommendations and stated that DCMA will reopen and properly disposition reports listed in Recommendation E.1. In addition, DCMA will place in Defer status the reports that are currently before the U.S. Court of Federal Claims or the Armed Service Board of Contract Appeals. DCMA will complete the actions by February 15, 2017.

Our Response

Comments from the Director, DCMA, addressed all specifics of the recommendation, and no additional comments are required. Once completed, we request that DCMA furnish the DoD OIG with documentation which supports that the contracting officers:

- reopened the reports listed in Recommendation E.1;
- properly dispositioned the reports listed in Recommendation E.1; and
- placed in Defer status those reports that are before the U.S. Court of Federal Claims or the Armed Service Board of Contract Appeals.

Appendix A

Scope and Methodology

We conducted this evaluation from November 2015 through November 2016 in accordance with the “Quality Standards for Inspection and Evaluation” published by the Council of the Inspectors General on Integrity and Efficiency in January 2012. Those standards require that we plan and perform the evaluation to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, conclusions, and recommendations based on our evaluation objectives. We believe that the evidence obtained provides a reasonable basis for our findings, conclusions, and recommendations based on our evaluation.

As part of the evaluation, we judgmentally selected 22 of 1,072 DCAA incurred cost reports issued between September 2013 and July 2015. To accomplish our objective, we:

- obtained and gained an understanding of the 22 audit reports;
- interviewed appropriate DCMA and DCAA employees;
- obtained and analyzed relevant DCAA and DCMA documents; and
- evaluated the actions that DCMA contracting officer took on the DCAA audit reports for compliance with the FAR, DoD Instruction 7640.02, and DCMA policy.

Use of Computer-Processed Data

In selecting DCAA audit reports for this review, we relied on a computerized DCAA list of audit reports that DCAA issued between September 2013 and July 2015. DCAA generated the listing from its management information system. We tested the accuracy of the listing by tracing the 22 selected reports to source documents. However, we did not test the listing for completeness.

Prior Report Coverage

During the last 5 years, the DoD OIG has issued one report on the actions that DCMA took in response to DCAA incurred cost audit reports, or the accuracy of the CAFU system. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

DoD OIG

DoD Office of Inspector General Report No. DODIG-2016-091, “Evaluation of the Accuracy of Data in the DoD Contract Audit Follow-Up System” May 13, 2016

We tested 50 CAFU audit records and found that 41 of the records had errors in one or more data fields. For example, we found 10 errors associated with the “Questioned Cost” data field because the amounts in the field did not comply with DoD Instruction 7640.02, “Policy for Follow-up on Contract Audit Reports,” April 15, 2015, which establishes recordkeeping and reporting requirements for contract audits.

Appendix B

Table 6. Summary of Findings by DCAA Audit Report

	DCAA Report No.	Questioned Direct Cost (Finding A)	Expressly Unallowable Cost (Finding B)	Inadequate Negotiation Memorandum/ Rate Letter (Finding C)	Timeliness of Resolution and Disposition (Finding D)	Accuracy of CAFU Data (Finding E)
1	1241-2008S10100001		X	X	X	X
2	1271-2007D10100003					X
3	1311-2006C10100006	X	X			X
4	2161-2007T10100001	X				X
5	2421-2007P10100002		X			X
6	2801-2008B10100101					X
7	3151-2007E10100004			X		
8	3151-2007E10100597		X	X		
9	3151-2008E10100104			X		
10	3161-2007F10100001	X	X	X		X
11	3181-2009D10100001	X				X
12	3321-2009K10100002	X			X	
13	4141-2006D10100003					X
14	4301-2008F10100001			X		
15	4531-2007K10100001	X			X	X
16	4531-2007K10100002					X
17	6271-2003A10100103	X	X	X		X
18	6311-2003C10100025			X		X
19	6311-2005C10100024			X		X
20	6741-2008Q10100003		X		X	X
21	6821-2006F10100001			X		
22	6281-2005G10100001	X			X	
	Total	8	7	10	5	15

Appendix C

Table 7. CAFU Accuracy Errors by DCAA Audit Report

	Report No.	Questioned Cost Sustained	Resolution Date	Disposition Date
1	1271-2007D10100003	X	X	X
2	1311-2006C10100006	X		X
3	2161-2007T10100001			X
4	2421-2007P10100002		X	
5	2801-2008B10100101	X		X
6	4141-2006D10100003	X		X
7	6271-2003A10100103		X	X
8	6311-2003C10100025		X	X
9	6311-2005C10100024		X	
10	6741-2008Q10100003		X	X
11	3161-2007F10100001		X	X
12	3181-2009D10100001			X
13	1241-2008S10100001		X	
14	4531-2007K10100001			X
15	4531-2007K10100002			X
	Total Errors	4	8	12

Appendix D

Table 8. Accuracy of CAFU Resolution and Disposition Dates

Report No.	CAFU Resolution Date	Actual Resolution Date	Variance in Days	CAFU Disposition Date	Actual Disposition Date	Variance in Days
1271-2007D10100003	06/19/2014	05/29/2014	21	10/06/2014	N/A ¹	
1311-2006C10100006				07/03/2014	06/26/2014	7
2161-2007T10100001				06/24/2014	N/A ²	
2421-2007P10100002	10/02/2014	08/11/2014	52			
2801-2008B10100101				6/22/2015	N/A ¹	
4141-2006D10100003				07/11/2014	06/12/2014	29
6271-2003A10100103	02/06/2014	04/21/2014	74	02/06/2014	N/A ²	
6311-2003C10100025	04/29/2014	02/27/2014	61	06/15/2015	06/09/2015	6
6311-2005C10100024	04/29/2014	02/27/2014	61			
3161-2007F10100001	06/26/2014	05/16/2014	41	08/14/2014	N/A ²	
6741-2008Q10100003	07/09/2015	05/20/2015	50	07/09/2015	06/22/2015	17
3181-2009D10100001				07/23/2015	N/A ²	
1241-2008S10100001	03/28/2014	10/22/2014	208			
4531-2007K10100001				11/05/2014	N/A ³	
4531-2007K10100002				09/15/2014	09/08/2014	7
Average Variance in Days			71			13

¹ Two CAFU records included the incorrect date in the disposition data field. The CAFU records should be in the Defer status due to litigation before the U.S. Court of Federal Claims or Armed Services Board of Contract Appeals.

² Four CAFU records incorrectly included a date in the disposition data field. The CAFU records should be considered open and in the resolution phase due to pending direct costs negotiations.

³ One CAFU record incorrectly included a date in the disposition data field. However, during our evaluation, the contracting officer appropriately updated the status of the record to open and resolved pending direct cost negotiations.

Appendix E

Other Matter of Interest

Written Extensions of Overdue Indirect Cost Rate Proposals Not Granted

FAR 42.705-1(b)(1)(ii) states that the contractor must submit an indirect cost rate proposal within six months following the end of each fiscal year. It also states, “[t]he contracting officer may grant, in writing, reasonable extensions, for exceptional circumstances only, when requested in writing by the contractor.”

In 10 of 22 instances, the DCMA contract file did not include evidence that the contracting officer granted the contractor a written extension of its overdue incurred cost rate proposal, as FAR 42.705-1(b)(1)(ii) requires. DCAA received the 10 proposals 25 months after the 6-month due date on average (see Table 9).

Table 9. Number of Months Indirect Cost Rate Proposals Submitted Past the 6-Month Due Date

	Audit Report Number	Indirect Cost Rate Proposal Due Date	Indirect Cost Rate Proposal Received Date	Number of Months Past Due Date
1	1271-2007D10100003	6/30/2008	11/30/2010	29
2	1311-2006C10100006	6/30/2007	11/24/2010	41
3	3151-2008E10100104	6/30/2009	11/09/2012	40
4	4141-2006D10100003	8/31/2007	6/13/2008	9
5	4301-2008F10100001	6/30/2009	9/18/2009	2
6	6281-2005G10100001	6/23/2006	7/15/2011	61
7	3181-2009D10100001	10/03/2009	10/01/2014	60
8	3321-2009K10100002	6/30/2010	5/18/2012	22
9	3151-2007E10100597	6/30/2008	10/08/2010	27
10	1241-2008S10100001	2/28/2009	7/17/2009	4
	Average Months Past Due Date			25

Obtaining the contractor’s incurred cost rate proposal in a timely manner is essential for:

- recouping unallowable cost paid to the contractor,
- identifying obligated funds that the contractor should return to the Government, and
- identifying overpayments based on differences between billed and final indirect rates.

Management Comments

Defense Contract Management Agency



DEFENSE CONTRACT MANAGEMENT AGENCY
3901 A AVENUE, BUILDING 10500
FORT LEE, VA 23801-1809

JAN 13 2017

MEMORANDUM FOR DEPARTMENT OF DEFENSE, INSPECTOR GENERAL, AUDIT
POLICY AND OVERSIGHT

SUBJECT: OIG Draft Report - Project No. D2016-DAPOCF-0006.000, "Evaluation of Defense
Contract Management Agency Contracting Officer Actions on Defense Contract Audit
Agency Incurred Cost Audit Reports," December 21, 2016

The attached is the Defense Contract Management Agency's response to the subject
DoDIG Draft Report dated December 21, 2016 that addresses DoDIG's recommendations.

The point of contact for this response is [REDACTED] at [REDACTED] or
[REDACTED]


Wendy M. Masiello, Lt Gen, USAF
Director

Attachment:
As stated

Defense Contract Management Agency (cont'd)

OIG Draft Report - Project No. D2016-DAPOCF-0006.000, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports," December 21, 2016

Report, page 5, Recommendation A: We recommend that the Director, Defense Contract Management Agency:

1. Request the six Defense Contract Management Agency contracting officers with negotiation authority to:

- a. take appropriate action on the Defense Contract Audit Agency reported questioned direct costs of \$297.6 million, and;
- b. document the action in a post negotiation memorandum, as DoD Instruction 7640.02 requires.

2. Direct the two remaining Defense Contract Management Agency contracting officers to:

- a. coordinate with the other DoD Component contracting officers having authority to negotiate the reported questioned direct costs of \$7.2 million; and
- b. incorporate the negotiation results from the other DoD Components in a post negotiation memorandum, as DoD Instruction 7640.02 requires.

DCMA concurs with recommendations A.1 and 2. We will request the contracting officers to reopen the audit assignments and take appropriate action to facilitate settlement of questioned direct costs associated with those assignments. The actions taken will be documented in a post negotiation memorandum and management review obtained in accordance with DCMA Instruction 126. We agree to coordinate with the other DoD Component contracting officers and incorporate those settlement results in the record. We will complete these efforts by May 2017.

Report, page 9, Recommendation B.1: We recommend that the Director, Defense Contract Management Agency:

- a. request the cognizant contracting officers to assess penalties (including interest) or, if appropriate, waive them in accordance with Federal Acquisition Regulation 4.709 for the sustained questioned costs reported as expressly unallowable in the seven Defense Contract Audit Agency reports, and

We concur with the recommendation B.1.a. to request the contracting officers to assess penalties, including interest (if appropriate), or waive the penalties, once each of the cases is reviewed for a determination of whether the costs questioned are expressly unallowable and an assessment of the merits of pursuing penalties and interest after the government has already signed agreement with the contractor. The actions will be completed by May 2017.

- b. Consider educational or correctional opportunities for each of the contracting officers that did not assess penalties or appropriately waive them, to

Defense Contract Management Agency (cont'd)

OIG Draft Report - Project No. D2016-DAPOCF-0006.000, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports," December 21, 2016

ensure the contracting officers are aware of their responsibilities for complying with Federal Acquisition Regulation 42.709.

We concur with the recommendation B.1.b to consider additional educational opportunities for the contracting officers involved with all the assignments of this report. We will incorporate the topic of penalties and interest into the agency Contract Audit Follow Up training for Cost Accounting Standards (CAS) and Incurred Cost Audits, to be provided via eConnect in March/April 2017.

c. improve the management review of contracting officer actions to better ensure contracting officers assess penalties for expressly unallowable costs or document a waiver of penalties that complies with Federal Acquisition Regulation 42.709-5.

We concur with recommendation B.1.c. Training to be provided in March/April 2017 for all ACOs and supervisors, will include emphasis on documentation of pre and post negotiations and the management review of all items addressed in these documents. The requirement for management review of the entire negotiation process is in the CAFU instruction (DCMA Instruction # 126), paragraphs 3.9.9 and 3.9.10. and in the Final Overhead Rates instruction (DCMA Instruction # 125), paragraphs 3.6 and 3.8.

Report, page 16, Recommendation C: We recommend that the Director, Defense Contract Management Agency:

1. Improve controls for ensuring the completeness and accuracy of negotiation documents in accordance with Federal Acquisition Regulation 42.705-1(b)(5), DoD Instruction 7640.02, and the Defense Contract Management Agency Instruction 125.

2. Provide refresher training to the contracting officers emphasizing DoD Instruction 7642.02, Defense Contract Management Agency Instruction requirements to:

a. address and document all audit findings, including any questioned direct costs, on the negotiation memorandum.

b. maintain evidence demonstrating that the contracting officer appropriately distributed negotiation documents, including the indirect cost rate agreement and negotiation memorandum.

c. Consider additional educational or correctional opportunities for those contracting officers that did not prepare adequate negotiation documents or distribute them in accordance with Federal Acquisition Regulation 42.706.

Defense Contract Management Agency (cont'd)

OIG Draft Report - Project No. D2016-DAPOCF-0006.000, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports," December 21, 2016

We concur with recommendations C.1. and 2. Our policy regarding final overheads sets forth the controls for ensuring the completeness and accuracy of negotiation documents in accordance with Federal Acquisition Regulation 42.705-1(b)(5), DoD Instruction 7640.02. The key control is the supervisory review and approval. What we intend to achieve with the aforementioned training to be provided (March/April 2017) to all contracting officers and their supervisors is to engage the supervisors and their direct reports in the discussions of what went wrong in the disposition of these cases. In addition, we will emphasize the importance and necessity of maintaining adequate documentation to support decisions and the requirement to document the decisions in pre and post negotiation documents, memorandums for record, and all other audit related correspondence. It will also cover the additional requirement to properly distribute the results of negotiation.

Report, page 18, Recommendation D: We recommend that the Director, Defense Contract Management Agency:

1. Request that the contracting officers assigned to Audit Report Numbers 6281-2005G10100001, 3321-2009K10100002 and 4531-2007K10100001:

- a. determine the actions they should take to appropriately disposition the audit findings;
- b. document the actions taken to achieve disposition at least monthly; and
- c. document the disposition of the audit findings in a negotiation memorandum.

2. Provide refresher training emphasizing the requirement for the Defense Contract Management Agency contracting officers to adequately update the contract audit follow-up record on a monthly basis with the cause for the delay and actions taken to achieve a timely resolution or disposition.

We concur with recommendations D.1. and 2. We will have the ACOs and their managers ensure the cited cases are properly dispositioned and actions are properly documented. Additionally, the training being provided via eConnect March/April 2017 will include emphasis on the contracting officer responsibility to adequately update the contract audit follow up record monthly and include actions taken.

Report, page 22, Recommendation E: We recommend that the Director, Defense Contract Management Agency:

1. Remove the disposition date entered in the Contract Audit Follow-up System for the following audit reports and reinstate the reports as unresolved until the contracting officer resolves and dispositions the questioned direct costs:

Defense Contract Management Agency (cont'd)

OIG Draft Report - Project No. D2016-DAPOCF-0006.000, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Reports," December 21, 2016

- a. **Audit Report No. 2161-2007T10100001**
- b. **Audit Report No. 3161-2007F10100001**
- c. **Audit Report No. 3181-2009D10100001**
- d. **Audit Report No. 6271-2003A10100103**

2. Remove the resolution date entered in the Contract Audit Follow-up System for the following audit reports and change their status to Defer while the audit issues are before the U.S. Court of Federal Claims or Armed Services Board of Contract Appeals:

- a. **Audit Report No. 1271-2007D10100003**
- b. **Audit Report No. 2801-2008B10100101**

We concur with recommendations E.1 and 2. The reports listed in E.1. will be reopened and properly dispositioned. The records that are currently before the U.S. Court of Federal Claims or the Armed Services Board of Contract Appeals will be placed in a deferred status until case decisions have been issued. The actions to change the status of these reports in the CAFU system will be completed by February 15, 2017.

Acronyms and Abbreviations

- DCAA** Defense Contract Audit Agency
- DCMA** Defense Contract Management Agency
- FAR** Federal Acquisition Regulation
- OIG** Office of Inspector General
- PNM** Post-Negotiation Memorandum
- PNOM** Pre-Negotiation Objective Memorandum

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