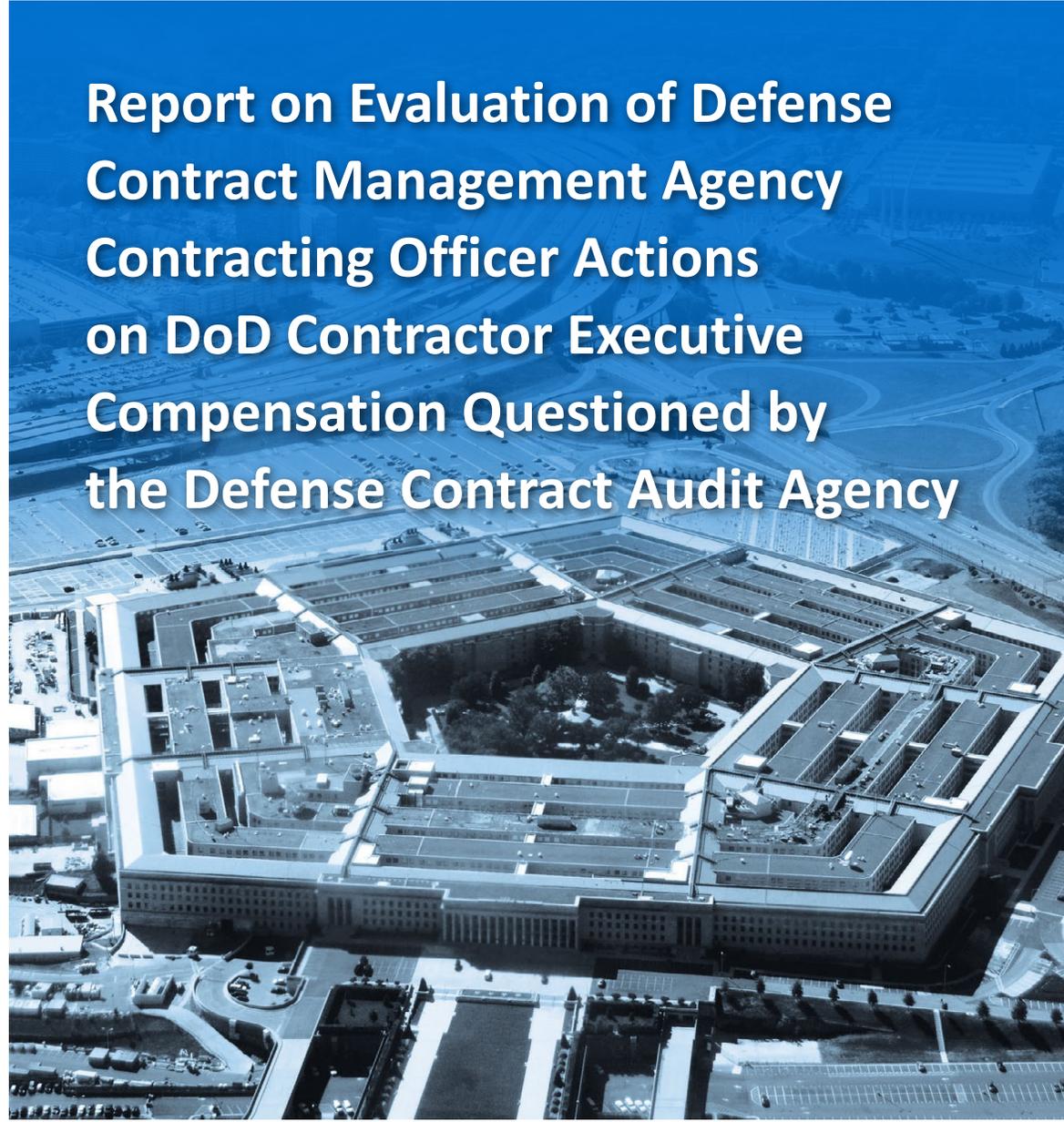




# INSPECTOR GENERAL

*U.S. Department of Defense*

MARCH 29, 2019



## Report on Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





# Results in Brief

## *Report on Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency*

March 29, 2019

### Objective

We determined whether the actions taken by Defense Contract Management Agency (DCMA) contracting officers on DoD contractor executive compensation questioned by Defense Contract Audit Agency (DCAA) complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy. To accomplish the objective, we evaluated DCMA contracting officer actions on 35 DCAA audit reports that questioned \$58.1 million in claimed DoD contractor executive compensation.

### Background

An executive typically plays a role in developing company strategy and policy and who directs, controls, and coordinates part or all of the company's activities.

The FAR is the primary regulation that all Federal Executive agencies must follow when they acquire supplies and services. FAR 31.205-6, Compensation for Personal Services, limits the amount of allowable compensation that contractors can claim on Government contracts. For example, the FAR imposes a compensation cap on the amount of compensation a contractor can claim for any individual employee. Also, the FAR requires that compensation paid to employees be reasonable for the personal services or jobs they perform. In determining whether employee compensation is reasonable, the FAR states that relevant factors may include whether the compensation conforms to the practices of similar companies.

DCAA audits DoD contractor compensation and other costs claimed on Government contracts to determine if the costs comply with the FAR and any other applicable criteria. To determine if the compensation that DoD contractors claim for its executives is reasonable, DCAA compares the DoD contractor's claimed compensation

### Background (cont'd)

to the average for comparable jobs published in private compensation surveys. If the claimed compensation exceeds the compensation survey average plus a 10 percent range of reasonableness (RoR) factor, DCAA typically questions the difference as unreasonable unless the DoD contractor can support above average compensation. DCAA issues an audit report on its findings and recommendations to a contracting officer for action.

If the contracting officer does not sustain DCAA's recommendations, the FAR and DoD Instruction 7640.02, "Policy or Follow-up of Contract Audit Reports," April 15, 2015, require the contracting officer to document rationale in the negotiation memorandum that adequately explains why DCAA's recommendations were not followed.<sup>1</sup>

### Findings

For 18 of 35 audit reports we selected for evaluation, DCMA contracting officers failed to comply with the FAR and DoD Instruction requirements to document adequate rationale when they do not sustain DCAA's recommendations. As a result of not sustaining the DCAA recommendations, the contracting officers reimbursed DoD contractors \$22.5 million in executive compensation that DCAA reported as unreasonable in the 18 audit reports. The 18 DCMA contracting officers documented one or more of the following three reasons for not sustaining the DCAA recommendations.

- DCAA's findings were not credible because two Armed Services Board of Contract Appeals cases had rejected DCAA's use of a 10 percent RoR factor.<sup>2</sup>
- The addition of locality pay to DCAA's calculated survey average effectively eliminated the executive compensation that DCAA identified as unreasonable.
- Grouping of the contractor's executives into one job class offset the executive compensation that DCAA identified as unreasonable.

<sup>1</sup> Contracting officers do not sustain questioned costs when they disagree with the DCAA audit findings and elect to reimburse the DCAA questioned costs to the contractor.

<sup>2</sup> The ASBCA is a neutral, independent forum whose primary function is to hear and decide post-award contract disputes between contractors and some Federal Executive agencies, including the DoD.



# Results in Brief

## *Report on Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency*

### **Findings (cont'd)**

However, none of these reasons adequately explain why the contracting officers did not sustain DCAA's recommendations. First, the two Armed Services Board of Contract Appeals did not reject DCAA's use of a 10 percent RoR factor in all instances. Second, the contracting officers did not justify the need to add locality pay to the DCAA calculated survey average. Third, the contracting officers did not explain how the grouping of executives in one job class was appropriate or met the definition of a job class in the FAR. As a result, the contracting officers may have inappropriately reimbursed the contractors up to \$22.5 million in unreasonable executive compensation.

We identified three factors that contributed to contracting officers not documenting adequate rationale when they did not sustain DCAA's recommendations.

- Contracting officers did not obtain a required legal review.
- DCMA management has not provided any guidelines, training, or specialist assistance to contracting officers that would help them appropriately and consistently address DCAA questioned executive compensation.
- Contracting officers did not obtain DCAA's opinion on additional information received from the contractor after issuance of the audit report.

Also, for 17 of the 35 audit reports, contracting officers did not maintain evidence that the negotiation memorandum and indirect cost rate agreement were distributed to the contracting officials affected by the negotiation, as the FAR requires. Additionally, for 9 of the 35 audits, the contracting officers could not demonstrate that they had provided a copy of the negotiation memorandum to DCAA. Appropriately distributing the negotiation memorandum and indirect cost rate agreement to affected contracting officials and DCAA is essential for ensuring that the negotiation results are incorporated in all affected Government contracts.

### **Recommendations**

We recommend that the DCMA Director implement either:

- a program whereby contracting officers may seek advice and assistance from qualified personnel with extensive knowledge on executive compensation, or
- guidelines and training to contracting officers on executive compensation concepts and approaches for taking action on executive compensation audit findings in a consistent and appropriate manner.

In addition, we recommend that the DCMA Director provide refresher training to contracting officers on the requirements to:

- Consult with legal counsel when their disagreement with an audit finding is based on an interpretation of a law or regulation.
- Obtain a Defense Contract Audit Agency opinion on additional information received from contractors after audit report issuance.

### **Management Comments and Our Response**

The DCMA Director agreed with the recommendations. The Director's comments and the planned actions are responsive and the recommendations are considered resolved. DCMA plans to provide training that emphasizes evaluating executive compensation using appropriate techniques, obtaining the required legal review, and requesting DCAA's opinion on additional information received from contractors. We will close the recommendations once we have verified the completion of DCMA's planned actions.

We request DCMA management furnish the DoD Office of Inspector General with documentation supporting the corrective actions taken once completed. Please see the Recommendations Table on the following page.

## Recommendations Table

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

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

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





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

March 29, 2019

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY

**SUBJECT:** Report on Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency (Report No. DODIG-2019-070)

We are providing this report for your information and use. We evaluated contracting officer actions on DoD contractor executive compensation questioned by the Defense Contract Audit Agency (DCAA). 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 Defense Contract Management Agency Director conformed 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 Mark Dixon at (703) 604-8739 (DSN 664-8739) or by e-mail [mark.dixon@dodig.mil](mailto:mark.dixon@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

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## Objective

We determined whether the actions taken by Defense Contract Management Agency (DCMA) contracting officers on DoD contractor executive compensation questioned by Defense Contract Audit Agency (DCAA) complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy.

To accomplish the objective, we evaluated DCMA contracting officer actions on 35 DCAA audit reports in which DCAA questioned \$58.1 million of DoD contractor executive compensation costs.

See Appendix A for a discussion of our scope and methodology.

## Background

### ***FAR Requirements***

An executive typically involves an employee who plays a role in developing company strategy and policy and who directs, controls, and coordinates part or all of the company's activities. If the company maintains an executive compensation plan, the executive will participate in the plan.

The FAR is the primary regulation that all Federal Executive agencies must follow when they acquire supplies and services. FAR 31.205-6, "Compensation for Personal Services," provides several criteria for determining whether DoD contractor compensation costs are allowable and reimbursable on Government contracts. For example, FAR 31.205-6(p), "Limitation on Allowability of Compensation," sets a compensation cap on the reimbursement of compensation costs paid to any individual contractor employee. The compensation cap is adjusted annually to reflect the change in the Employment Cost Index reported by the Bureau of Labor Statistics. For 2018, the compensation cap was set at \$525,000.

In addition, FAR 31.205-6(b)(2), "Compensation Not Covered by Labor-Management Agreements," requires that compensation paid to contractor employees must be reasonable for the personal services or jobs they perform. FAR 31.201-3(a), "Determining Reasonableness," states:

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business....No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an

initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

The compensation paid for a particular job may not be reasonable even though it does not exceed the compensation cap. FAR 31.205-6(b)(2) states that relevant factors for determining the reasonableness of compensation may include whether the compensation paid by a contractor conforms to the practices of similar companies based on size, industry, and geography. Another relevant factor may include the compensation practices of companies engaged in similar non-government work under comparable circumstances.

### ***Compensation Surveys***

To compare the compensation practices of similar companies, contractors routinely benchmark their jobs against comparable jobs published in compensation surveys.<sup>3</sup> Reputable compensation surveys use industry accepted methods of data gathering and statistical analysis to determine and report on how much companies pay for a specific job. As reflected in FAR 31.205-6(b)(2), contractors must carefully consider the relevant factors for the job being benchmarked, such as companies of similar size, industry, and geographic location. The degree to which each factor is relevant will vary by job. For example, company size may be a more relevant factor in determining the prevailing compensation for a senior executive than for a plumber. In addition, the accuracy of the contractor's job descriptions are critical for selecting a comparable job published in compensation surveys. Finally, human resource organizations, such as WorldatWork, recommend the use of more than one survey to obtain a robust market consensus and to address any minor data anomalies that may exist in one survey source.<sup>4</sup>

### ***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 costs incurred and claimed on Government contracts.

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<sup>3</sup> A benchmark is a standard or point of reference against which compensation may be compared or assessed.

<sup>4</sup> Founded in 1955, WorldatWork serves as a leading nonprofit professional association in compensation and total rewards. It offers education, certification programs, and other services to the compensation professional community.

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

The DCAA audit of the contractor's indirect costs includes auditing the contractor's claimed executive compensation for allowability and reasonableness. DCAA maintains a team of compensation specialists who evaluate executive compensation claimed by DoD contractors for compliance with FAR 31.205-6.

When auditing the reasonableness of claimed executive compensation, DCAA compares the contractor's claimed compensation to the average for comparable jobs published in reputable compensation surveys. DCAA follows the steps outlined in Armed Services Board of Contract Appeals (ASBCA) Case No. 41470 involving Techplan Corporation (hereafter referred to as the Techplan case) to conduct the survey comparisons.<sup>5</sup> One of the Techplan case steps involves identifying compensation surveys for the position to be compared that match the company in terms of relevant factors, such as revenues and industry. DCAA typically uses three compensation surveys to obtain a robust market consensus, including the contractor's survey if the contractor grants DCAA access to it.

Another step from the Techplan Case includes applying a range of reasonableness (RoR) factor to the survey average. DCAA adds a 10 percent RoR factor as a means of identifying only compensation that significantly exceeds the survey average. The use of a 10 percent RoR factor is widely used and accepted by compensation specialists and human resource organizations. If the contractor's claimed compensation for a particular executive is higher than the survey average plus the 10 percent RoR factor, DCAA questions the difference as unreasonable unless the contractor can justify the difference. A contractor can often justify higher executive compensation than the survey average by demonstrating that its financial performance was superior to its competitors.

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<sup>5</sup> The ASBCA is a neutral, independent forum that 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 ASBCA matters involve contractors that appeal a Government contracting officer final decision or a failure to issue a decision.

In FY 2016 and FY 2017, DCAA auditors questioned contractor executive compensation of approximately \$338 million and \$206 million, respectively, as a result of determining that the compensation was unreasonable in accordance with FAR 31.205-6(b)(2).

### ***Defense Contract Management Agency***

DCMA operates in accordance with DoD Directive 5105.64, "Defense Contract Management Agency," January 10, 2013. DCMA functions under the authority, direction, and control of the Under Secretary of Defense for Acquisition and Sustainment. DCMA works with DoD contractors to ensure Government supplies and services are delivered on time and at the 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 DoD contractor business systems, evaluating DoD contractor compliance with the Cost Accounting Standards, and establishing final indirect cost rates. In most cases, DCMA contracting officers are responsible for taking action on DCAA indirect cost audit reports and reaching a final indirect cost rate agreement with the contractor. The indirect cost rate agreement, which the DCMA contracting officer prepares annually, establishes the indirect cost rates that the DoD contractor must use to bill the Government and close contracts. Once signed, the indirect cost rate agreement represents a binding agreement between both the Government and the DoD contractor.

### ***DoD Instruction 7640.02***

DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," April 15, 2015, establishes policy, assigns responsibilities, and provides direction for reporting requirements and follow-up procedures on DCAA audit reports, including indirect cost audit reports. The Instruction requires that contracting officers:

- document adequate rationale for disagreeing with DCAA audit findings and recommendations in the negotiation memorandum,
- consult with legal counsel and document the legal basis in the contract file when a disagreement with DCAA findings or recommendations is based on an interpretation of law or regulation, and
- provide a copy of the negotiation memorandum to the DCAA auditor and other affected Government offices.

## Finding A

### Inadequate Rationale for Not Sustaining DCAA Questioned Executive Compensation

For 18 of the 35 audit reports we selected, DCMA contracting officers failed to document adequate rationale when they did not sustain DCAA questioned executive compensation totaling \$22.5 million. DCAA questioned the executive compensation as unreasonable in accordance with FAR 31.205-6(b)(2). The DCMA contracting officers commonly documented one or more of the following three reasons for not sustaining the DCAA recommendations.

- DCAA's findings were not credible because two Armed Services Board of Contract Appeals cases had rejected DCAA's use of a 10 percent RoR factor.
- The addition of locality pay to DCAA's calculated survey average effectively eliminated the executive compensation that DCAA identified as unreasonable.
- Grouping all of the DoD contractor's executives into one job class offset the executive compensation that DCAA identified as unreasonable.

However, none of these reasons adequately justify why the contracting officers did not sustain the DCAA questioned executive compensation. As a result, the contracting officers may have inappropriately reimbursed DoD contractors up to \$22.5 million in unreasonable executive compensation.

We identified the following three factors that contributed to the failure of DCMA contracting officers to document adequate rationale when they disagreed with the DCAA audit findings:

- Contracting officers did not obtain a required legal review.
- DCMA management has not developed any executive compensation guidelines or training, or provided contracting officers with specialist assistance to help them appropriately and consistently address DCAA questioned executive compensation.
- Contracting officers did not obtain DCAA's opinion on additional information received from the contractor after audit report issuance.

## Requirements for Documenting Actions on DCAA Recommendations

FAR 42.705-1(b)(5)(iii)(C), “Contracting Officer Determination Procedure,” and DoD Instruction 7640.02, Enclosure 3, paragraph 3(b), require contracting officers to prepare a negotiation memorandum that includes the:

- disposition of significant matters in the audit report,
- reconciliation of all costs questioned in the audit report, with identification of items and amounts that the contracting officer allowed or disallowed in the final settlement, and
- reasons why any recommendations of the auditor or other Government advisors were not followed by the contracting officer.

DCMA Instruction 125, “Final Overhead Rates,” April 21, 2014, reiterates these requirements and emphasizes that contracting officers must include sound rationale in the negotiation memorandum when they disagree with audit findings and recommendations.

DoD Instruction 7640.02, Enclosure 3, paragraph 3(b), and DCMA Instruction 126, “Contract Audit Follow-up,” August 22, 2013, also require that contracting officers consult with legal counsel and document the legal basis when a disagreement with DCAA findings or recommendations is based on an interpretation of law or regulation.

## DCAA Audit Findings

As part of our evaluation, we selected 35 DCAA audit reports that questioned \$58.1 million in executive compensation. DCAA questioned the executive compensation during its evaluation of DoD contractor indirect cost proposals.

Of the \$58.1 million questioned in the 35 audit reports, DCAA questioned \$36.2 million because it determined that the costs were unreasonable in accordance with FAR 31.205-6(b)(2) and FAR 31.201-3. In each case, DCAA’s determination was based on the steps in the Techplan case, which involved comparing the claimed compensation for various executives to a market average for comparable positions published in compensation surveys. DCAA typically used three compensation surveys, which may have included the contractor’s survey used to administer its executive compensation if the contractor granted DCAA access to it. DCAA also added a 10 percent RoR factor to the survey average and, in most cases, questioned as unreasonable any claimed executive compensation that exceeded the survey average plus the 10 percent RoR factor.

DCAA questioned the remaining \$21.9 million (\$58.1 million less \$36.2 million) for various reasons other than reasonableness. For example, DCAA questioned the costs of an executive engaged in lobbying activities that were unallowable in accordance with FAR 31.205-22, “Lobbying and Political Activity Costs.”

## Inadequate Rationale for Disagreeing With DCAA Recommendations

Of the \$58.1 million in DCAA questioned costs, the DCMA contracting officers did not sustain \$31.3 million of the costs. Table 1 shows a breakdown of the type of questioned costs sustained and not sustained by contracting officers.

*Table 1. Questioned Compensation Not Sustained (in millions)*

Basis for the DCAA Questioned Costs	DCAA Questioned Executive Compensation	Questioned Costs Sustained By Contracting Officers	Questioned Costs Not Sustained by Contracting Officers	Percent of Questioned Costs Not Sustained
Questioned As Unreasonable	\$36.2	\$11.6	\$24.6	68%
Questioned For Other Reasons	21.9	15.2	6.7	31%
<b>Total</b>	<b>\$58.1</b>	<b>\$26.8</b>	<b>\$31.3</b>	<b>54%</b>

### ***Contracting Officer Actions on Costs Questioned as Unreasonable***

For the 35 DCAA audit reports, contracting officers did not sustain \$24.6 million of the \$36.2 million in executive compensation that DCAA questioned as unreasonable. For 17 of 35 audits, the contracting officers adequately documented adequate rationale for disagreeing with the DCAA questioned executive compensation. For the remaining 18 audit reports, we determined that DCMA contracting officers did not document adequate rationale in the negotiation memorandum for disagreeing with the DCAA questioned executive compensation, as FAR 42.705-1(b)(5)(iii) and DoD Instruction 7640.02 requires. Appendix B identifies the 18 DCAA audit reports in which DCMA contracting officers failed to document adequate rationale for disagreeing with executive compensation questioned by DCAA.

Within the 18 DCAA audit reports, DCAA questioned \$30.2 million in executive compensation as unreasonable, and contracting officers did not sustain \$22.5 million (75 percent) of the costs. Because the contracting officers did not document adequate rationale on the 18 audit reports, they failed to justify

their actions and may have inappropriately reimbursed the \$22.5 million to DoD contractors. Table 2 shows a breakdown of the executive compensation questioned as unreasonable by the adequacy of the contracting officers' rationale.

*Table 2. Questioned Unreasonable Compensation Sustained and Not Sustained by the Adequacy of the Contracting Officers' Rationale (in millions)*

Adequacy of Contracting Officer Rationale	No. of Audit Reports	DCAA Questioned Costs	Questioned Costs Sustained By Contracting Officers	Questioned Costs Not Sustained by Contracting Officers	Percent of Questioned Costs Not Sustained
Inadequate	18	30.2	7.7	22.5	75%
Adequate	17	6.0	3.9	2.1	35%
<b>Total</b>	<b>35</b>	<b>\$36.2</b>	<b>\$11.6</b>	<b>\$24.6</b>	<b>68%</b>

In most instances, the contracting officers assigned to the 18 audit reports documented one or more of following three reasons for not sustaining the \$22.5 million in DCAA questioned costs:

- DCAA's findings were not credible because two ASBCA cases had rejected DCAA's use of a 10 percent RoR factor.
- Addition of locality pay to DCAA's calculated survey average effectively eliminated the executive compensation that DCAA identified as unreasonable.
- Grouping all of the DoD contractor's executives into one job class offset the executive compensation that DCAA identified as unreasonable.

As detailed below, we determined that none of these reasons adequately justify why the contracting officers did not sustain DCAA's recommendations.

### *DCAA's Use of the RoR Factor*

DCAA adds a 10 percent RoR factor to help identify and question only claimed executive compensation that significantly exceeds the survey average. DCAA would actually question a larger amount of compensation as unreasonable if it did not add the RoR factor to the survey average. To illustrate, if Contractor ABC claims \$325,000 for its Executive Vice President and DCAA calculates a survey average of \$300,000, DCAA would not question any of the compensation because the compensation does not exceed \$330,000 (\$300,000 plus a 10 percent RoR factor). Without the use of the RoR factor, DCAA would question \$25,000 as unreasonable (\$325,000 less \$300,000).

In addition, the use of a 10 percent RoR is accepted by WorldatWork and several professional compensation publications, including the “Guide to Market Pricing” published by Mercer Human Resource Consulting.

For 7 of 18 audit reports, contracting officers did not sustain the questioned executive compensation based on the contracting officers’ interpretation that the following two ASBCA cases had rejected DCAA’s use of the 10 percent RoR factor.

- ASBCA Case No. 56624, June 4, 2012, involving Metron Incorporated (hereafter referred to as the Metron case), and
- ASBCA Case No. 56105, January 18, 2012, involving JF Taylor, Incorporated (hereafter referred to as the JF Taylor case).

For example, in Audit Report No. 3151-2011U10100001, DCAA questioned \$3.7 million in claimed compensation of 44 executives as unreasonable in accordance with FAR 31.205-6(b)(2), which requires that compensation paid to contractor employees must be reasonable for the personal services or jobs they perform. DCAA questioned the executive compensation only when the compensation exceeded the survey average plus a 10 percent RoR factor. The contracting officer documented in his negotiation memorandum that he did not sustain the DCAA questioned costs because the Metron and JF Taylor cases had rejected DCAA’s use of the 10 percent RoR factor.

The contracting officers’ interpretation of the Metron and JF Taylor cases is inaccurate. In the Metron case, the ASBCA did not reject the use of an RoR factor. In fact, the ASBCA concluded that a contractor’s claimed executive compensation was reasonable after it added a 10 percent RoR factor to the survey amount used by the contractor. In the JF Taylor case, the ASBCA did not reject the use of an RoR factor in all instances. Instead, the ASBCA relied on un rebutted contractor testimony which argued that a 10 percent RoR factor may have been insufficient to account for the data dispersion that existed in the specific compensation survey data used in that case.<sup>6</sup> However, the seven contracting officers who disagreed with the DCAA questioned executive compensation failed to establish a degree of dispersion in the survey data that was comparable to the JF Taylor case.

Therefore, we determined the seven contracting officers failed to document adequate rationale when they did not sustain the DCAA questioned executive compensation based on the Metron and JF Taylor cases.

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<sup>6</sup> Data dispersion refers to the variation of data around a central value.

### *Addition of Locality Pay*

For 7 of the 18 audit reports, the contracting officers reduced or eliminated the DCAA questioned executive compensation by adjusting DCAA's calculated survey average for locality pay. For example, in Audit Report No. 2211-2009S10100001, DCAA questioned a total of \$3.8 million in claimed compensation paid to 52 executives in 2009 as unreasonable based on FAR 31.205-6(b)(2). The contracting officer increased DCAA's calculated survey averages for each executive by 27.96 percent for locality pay. The locality pay percentage was based on the 2009 locality pay adjustment of 27.96 percent for General Scale Federal employees working in New York City. After adding the locality pay, the contracting officer determined that none of the claimed executive compensation for the 52 executives was unreasonable. Therefore, he did not sustain any of the \$3.8 million that DCAA had questioned. The contracting officer stated to us that he believes DoD contractor executives should receive the same locality pay as Federal employees assigned to the General Scale.

Executives are typically recruited, retained, and lost from a nationwide market of executive talent. Therefore, the consensus among reputable compensation organizations, such as WorldatWork and the American Compensation Association, is that the relevant labor market for executives is a national or international market rather than a specific locality. Further, compensation for executive positions varies more directly with an executive's scope of responsibility relative to company size. For example, a Chief Information Officer of a company with \$500 million in annual sales will generally be compensated higher than a Chief Information Officer of a company with \$3 million in annual sales. Another relevant factor may include the company's industry in which company competes for executive talent. As a result, most reputable compensation surveys publish the survey results of executive positions only by company size and industry.

In addition, locality pay included in the General Schedule covers only Federal employees in professional, technical, administrative, and clerical positions. In 2009, the General Schedule annual salary, including locality pay, for New York City ranged between \$22,444 and \$153,200. In contrast, the contractor's 52 executives received an average annual salary of approximately \$458,000. Furthermore, the Government maintains separate pay schedules for executive-level positions, such as the Senior Executive Service and the Executive Schedule, which do not include locality pay. Therefore, we determined that the use of locality pay to increase DCAA's calculated survey averages for each executive is not appropriate. The contracting officer failed to explain in his negotiation memorandum why the addition of the 27.96 percent locality pay, based on the 2009 General Schedule for New York City, was appropriate for establishing whether the contractor's executive compensation was reasonable.

For the remaining six audit reports, the contracting officers similarly failed to adequately explain why they adjusted DCAA's calculated survey average for locality pay to determine whether the contractor's executive compensation was reasonable. As a result, the contracting officers did not comply with the FAR 42.705-1(b)(5)(iii)(C) requirement for documenting adequate rationale when they disagreed with the audit findings.

### *Grouping of Executives Into One Job Class*

FAR 31.205-6(b) states that compensation for each employee or job class of employees must be reasonable for the work performed. FAR 31.001, "Definitions," defines a "Job Class of Employees" as employees performing in positions within the same job. FAR 31.001 defines a job as a homogeneous cluster of work tasks. Taken as a whole, the collection of tasks, duties, and responsibilities constitutes the assignment for one or more individuals whose work is of the same nature and is performed at the same skill and responsibility level.

An executive position typically involves unique skills, duties, and responsibilities. As a result, DCAA audits the reasonableness of executive compensation on an individual basis in most cases. This audit methodology is consistent with a March 14, 1991, memorandum issued by the Director of Procurement and Acquisition Policy, which states that:

The Government should determine the reasonableness of executive compensation on an individual basis.

In 5 of 18 audit reports, we found that the DCMA contracting officers grouped the contractor's executives into one job class without adequately demonstrating that the executives being grouped had similar tasks, duties, and responsibilities. The contracting officers then concluded that the job class they created was reasonable in relation to DCAA's calculated survey average. Grouping executives into one job class has the effect of offsetting the compensation of executives above the survey average (that DCAA questioned as unreasonable) with the compensation of other executives below the survey average. Table 3 illustrates how one of the five contracting officers grouped executives into one job class, thus offsetting the DCAA questioned costs against executives paid below the DCAA calculated survey average.

Table 3. Illustration of the Effect on Grouping Executives Into One Job Class

Executive Job Title	Claimed Compensation	DCAA Calculated Survey Average	DCAA Questioned Costs (Above the Survey Average)	Contracting Officer Determination (Above and Below the Survey Average)*
Corporate VP, Communications	\$1,411,191	\$ 788,544	\$ 622,647	\$ 622,647
Corporate VP, Treasurer	893,865	1,150,807	0	(256,942)
Corporate VP, Human Resources	670,772	1,196,753	0	(525,981)
Corporate Director	780,352	1,073,514	0	(293,162)
VP, Financial Planning	992,667	405,555	587,112	587,112
VP, Contracts Pricing	834,261	1,106,596	0	(272,335)
VP, Administrative Services	714,588	320,808	393,780	393,780
Corporate VP, Administration	1,954,179	2,201,960	0	(247,781)
VP, Programs	699,299	901,572	0	(202,273)
<b>Total</b>	<b>\$8,951,174</b>	<b>\$9,146,109</b>	<b>\$1,603,539</b>	<b>\$(194,935)</b>

\* Represents the difference between the claimed compensation and the DCAA calculated survey average.

As a result of determining that the total claimed executive compensation was \$194,935 below the DCAA calculated survey average for the nine executives, the contracting officer did not sustain any of the \$1,603,539 in DCAA questioned costs. However, we found that the tasks, duties, and responsibilities of the nine executives were not similar. Therefore, we determined that the contracting officer had inappropriately grouped the nine executives into a job class without considering whether the executives collectively met the definition of a job class of employees in FAR 31.001.

For the four remaining audit reports, the contracting officers did not adequately explain or demonstrate in the negotiation memorandum how the grouped executives met the FAR 31.001 definition of a job class. Therefore, the contracting officers did not comply with the FAR 42.705-1(b)(5)(iii)(c) requirement for documenting adequate rationale when they disagree with the DCAA questioned costs.

## ***Contracting Officer Actions on Costs Questioned for Other Reasons***

Contracting officers did not sustain \$6.7 million of the \$21.9 million that DCAA questioned for other reasons. We determined that the contracting officers documented adequate rationale in the negotiation memorandum for not sustaining the DCAA questioned costs of \$6.7 million. For example, in Audit Report No. 2012H10100001, DCAA questioned \$3.1 million of executive compensation associated with lobbying, public relations, and advertising activities that were unallowable in accordance with FAR 31.205, Selected Costs. After the issuance of the DCAA audit report, the DoD contractor furnished the contracting officer with additional support showing that the executives had engaged in less of these unallowable activities than DCAA had originally reported. Based on his consideration of the additional support, the contracting officer sustained \$2.1 million of the \$3.1 million questioned by DCAA. The contracting officer documented adequate rationale for not sustained the remaining \$1 million that DCAA had questioned. Therefore, we agreed with the contracting officer's determination.

## **Contributing Factors**

We identified three factors that contributed to contracting officers not documenting adequate rationale when they disagreed with the DCAA questioned costs.

### ***Contracting Officer Failure to Obtain a Required Legal Opinion***

For all 18 instances in which contracting officers did not document adequate rationale, the contracting officers did not consult with legal counsel. DoD Instruction 7640.02 and DCMA Instruction 126 required that the 18 contracting officers consult with legal counsel because their disagreement with the questioned executive compensation costs involved an interpretation of a law or regulation.

Specifically, the 18 contracting officers interpreted FAR 31.205-6 and other regulatory citations differently than DCAA. For example, when five contracting officers decided to group executives into a single job class, they interpreted the definition of a job class in FAR 31.001 differently than DCAA. Therefore, the contracting officers should have obtained a legal opinion to ensure that their interpretation of the FAR was accurate.

A legal opinion was also warranted because, in some instances, the contracting officers' disagreement with DCAA was based on their interpretation of complex ASBCA legal rulings. The contracting officers should have obtained a legal opinion to ensure that they appropriately interpreted and applied the ASBCA rulings when

they used them as a basis to not sustain the DCAA recommendations. For example, the seven contracting officers that disagreed with DCAA's use of the 10 percent RoR factor should have consulted with legal counsel to help ensure their decision was based on an appropriate interpretation and application of the Metron and JF Taylor cases.

As a result of not obtaining a required legal review, the 18 contracting officers bypassed a key control established by DoD to help ensure that contracting officer determinations comply with applicable regulations and DoD policy.

Nine of the 18 contracting officers stated that they did not believe the disagreement with DCAA was based on an interpretation of a law or regulation. DCMA should provide contracting officers with refresher training to clarify when they are required to obtain a legal opinion.

### ***Lack of DCMA Guidelines, Training, or Specialist Advice for Addressing DCAA Questioned Executive Compensation***

Based on our review of existing DCMA procedures, we found that DCMA has not established any procedures or guidelines for addressing questioned executive compensation costs. In addition, DCMA has not furnished training to its contracting officers on how to appropriately evaluate the merits of executive compensation questioned by DCAA. Furthermore, DCMA has not developed a program whereby contracting officers can obtain advice from a specialist on complex compensation issues to help ensure that the contracting officers make appropriate and consistent decisions on DCAA questioned compensation costs.

With guidelines and training, or a program for seeking specialist advice, contracting officers would have the tools necessary to make independent and informed decisions that are consistent and compliant with applicable regulations. Our evaluation identified instances in which contracting officers were inconsistent in their approach to negotiating questioned executive compensation costs. For example, seven contracting officers rejected DCAA's use of the 10 percent RoR factor, but the remaining 28 contracting officers accepted it. In another example, seven contracting officers added locality pay, but the remaining 28 contracting officers did not add locality pay.

### ***Failure to Obtain DCAA's Opinion on Additional Contractor Information***

FAR 42.705-1(b)(4)(i)(B) states that the contracting officer must not resolve any questioned costs until they obtain DCAA's opinion on the allowability of the costs. DCMA Instruction 125, paragraph 3.6.2.1, implements FAR 42.705-1 and further states that contracting officers must obtain the auditor's opinion on additional documentation they receive from contractors after issuance of the DCAA audit report.

For 7 of the 18 audit reports, contracting officers received additional information from contractors to dispute the DCAA questioned costs and support the reasonableness of the executive compensation. However, the contracting officers did not obtain DCAA's opinion on the additional information received from the contractors, as DCMA Instruction 125 requires.

For example, in Audit Report No. 6821-2009G1010001, DCAA questioned \$913,000 in executive compensation as unreasonable. The contractor subsequently submitted additional survey information which benchmarked the executives to higher-level survey positions than DCAA used. The contracting officer accepted the contractor's approach without consulting with DCAA on the appropriateness and accuracy of benchmarking the executives to the higher-level survey positions. As a result of accepting the contractor's approach, the contracting officer did not sustain the DCAA questioned costs of \$913,000.

DCMA should provide refresher training addressing the DCMA 125 Instruction requirement to consult with DCAA on additional information received from contractors after issuance of an audit report.

### **Conclusion**

For 18 of 35 audit reports, DCMA contracting officers did not comply with FAR 42.705-1 when they failed to document adequate rationale for disagreeing with DCAA questioned executive compensation. As a result, contracting officers may have inappropriately reimbursed \$22.5 million in unreasonable executive compensation costs.

We identified three factors that contributed to contracting officers not documenting adequate rationale in the negotiation memorandum, including the failure of contracting officers to obtain a required legal opinion and seek DCAA's opinion on additional information received from contractors after audit report issuance.

## Recommendations, Management Comments, and Our Response

### **Recommendation A.1**

**We recommend that the Defense Contract Management Agency Director develop procedures and processes for addressing Defense Contract Audit Agency findings on executive compensation by implementing either:**

- a. A program whereby contracting officers may seek advice and assistance from personnel with extensive knowledge on executive compensation, or**
- b. Guidelines and training for contracting officers that address executive compensation concepts and approaches for taking action on executive compensation audit findings in an appropriate and consistent manner.**

### *Defense Contract Management Agency Director Comments*

The DCMA Director agreed and stated that DCMA will take two immediate actions. First, DCMA will encourage contracting officers to use its Indirect Cost Control email box to ask questions on executive compensation issues. DCMA personnel with appropriate experience will monitor the email box and provide guidance to the contracting officers. Second, DCMA will post training slides covering executive compensation on the DCMA intranet page. By March 31, 2019, DCMA will issue a memorandum that formally notifies all contracting officers of these two resources.

In addition, by September 30, 2019, DCMA will conduct training sessions on the proper techniques for evaluating questioned executive compensation.

In a subsequent March 11, 2019, e-mail, the DCMA Contract Policy Director clarified that the planned training sessions will comprehensively address the topics addressed in this report, including DCAA's use of an RoR factor, the addition of locality pay, and the grouping executives into one job class.

### *Our Response*

Comments from the DCMA Director and the subsequent email from the DCMA Contract Policy Director addressed all specifics of the recommendation. We consider the recommendation resolved; however, this recommendation will remain open until we determine that the training adequately addresses the executive compensation issues identified in this report.

## **Recommendation A.2**

We recommend that the Defense Contract Management Agency Director provide refresher training to contracting officers on the requirements to:

- a. **consult with Agency legal counsel when their disagreement with an audit finding is based on an interpretation of a law or regulation, in accordance with DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," April 15, 2015, and**
- b. **obtain a Defense Contract Audit Agency opinion on additional information received from contractors after audit report issuance, in accordance with DCMA Instruction 125, "Final Overhead Rates," April 21, 2014.**

### *Director, Defense Contract Management Agency, Comments*

The DCMA Director agreed and stated that DCMA will take three corrective actions to reinforce DCMA policy. First, in an upcoming teleconference, DCMA will remind all DCMA Contract Directors of the two requirements for consulting with DCMA legal counsel and for obtaining DCAA's opinion on additional information that contracting officers receive during negotiations. Second, DCMA will issue a memorandum that reminds all contracting officers of these two requirements. Third, DCMA will emphasize these requirements in the aforementioned training sessions being provided to contracting officers by September 30, 2019.

### *Our Response*

Comments from the Director, DCMA, addressed all specifics of the recommendation and we consider this recommendation to be resolved. However, the recommendation will remain open until DCMA provides evidence that training was furnished to all contracting officers on the requirements for obtaining a legal review and for requesting DCAA's opinion on additional contractor information received during negotiations.

## Finding B

### **DCMA Did Not Distribute Negotiation Documents to Affected Contracting Officials and DCAA**

Prompt distribution of the negotiation memorandum and the indirect cost rate agreement to other affected contracting officials is essential for ensuring that the negotiation results are incorporated in all contracts.

For 17 of the 35 audits we selected, the contracting officers did not maintain evidence that they had distributed the negotiation memorandum and indirect cost rate agreement to other contracting officials affected by the negotiation, as FAR 42.706, "Distribution of Documents," and DCMA Instruction 125 require. As a result, the affected contracting officers may not have been able to accurately determine final allowable costs on Government contracts. Twelve contracting officers acknowledged that they did not distribute the negotiation memorandum and indirect cost rate agreement. The remaining five contracting officers stated that they believed the documents had been distributed to the affected contracting officials, but they could not furnish any evidence that the documents had been distributed.

Additionally, for 9 of the 35 audits we selected, the contracting officers could not demonstrate that they had provided a copy of the negotiation memorandum to DCAA, as DCMA Instruction 125 requires. Five contracting officers acknowledged that they did not distribute the negotiation memorandum and indirect cost rate agreement to DCAA. Four contracting officers stated that they believed the documents had been distributed to DCAA, but they could not furnish any evidence that the documents had been distributed.

In response to prior Report No. DODIG-2017-055, DCMA developed refresher training that reminds contracting officer of the requirements for distributing the negotiation memorandum and indirect rate agreement. DCMA is in the process of conducting the refresher training to all DCMA contracting officers and supervisors.

## Requirements for Distributing Negotiation Documentation

FAR 42.706 requires contracting officers to promptly distribute a copy of the:

- negotiation memorandum and indirect cost rate agreement to affected contracting agencies, and
- negotiation memorandum to DCAA.

DCMA Instruction 125, paragraph 3.8.5.2, also requires that contracting officers distribute the indirect cost rate agreement to DCAA. DCMA Instruction 125, paragraph 3.3.3, further requires that contracting officers document the date and method of distributing the negotiation memorandum and indirect cost rate agreement in the contract file.

## Negotiation Documents Were Not Distributed to Affected Contracting Officials or to DCAA

Promptly distributing the negotiation memorandum and indirect cost rate agreement to affected contracting officials and to DCAA is essential for ensuring that the negotiation results are incorporated in all impacted contracts. Government officials use these documents to determine allowable costs on Government contracts.

For the 35 audits, we evaluated whether the DCMA contract files included evidence that contracting officers distributed copies of the negotiation memorandum and indirect cost rate agreement to affected contracting officials and to DCAA, as FAR 42.706 and DCMA Instruction 125 require.

For 17 of the 35 audit reports, the contracting officers could not demonstrate that the negotiation memorandum and indirect cost rate agreement were furnished to contracting officials affected by the negotiation. As a result, the affected contracting officials may not have been able to accurately determine final allowable costs on Government contracts. We asked the 17 contracting officers whether they recalled actually distributing the negotiation memorandum and indirect cost rate agreement to affected contracting officials. Five contracting officers stated that they believed the documents had been distributed to the affected contracting officials, but the contracting officers could not furnish any evidence that the documents had been distributed. The remaining 12 contracting officers acknowledged that they did not distribute the documents.

Also, for 9 of the 35 audit reports, the contracting officers could not demonstrate that they had provided the negotiation memorandum and indirect rate agreement to DCAA, as FAR and DCMA Instruction 125 require. Furnishing these documents to DCAA helps DCAA record the negotiation results, perform final contract audits, and make future audit support more effective. We asked the nine contracting officers whether they distributed the negotiation memorandum and indirect cost rate agreement to DCAA. Four contracting officers stated that they believed the documents had been distributed to DCAA, but the contracting officers could not furnish any evidence that the documents had been distributed. The remaining five contracting officers acknowledged that they did not distribute the negotiation memorandum and indirect cost rate agreement.

## Management Actions on Prior Recommendations

In 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, we reported that eight DCMA contracting officers did not maintain evidence of distributing the negotiation memorandum and the incurred cost rate agreement. We recommended that DCMA provide refresher training to the DCMA contracting officers on the requirement to maintain evidence of distributing negotiation documents, including the indirect cost rate agreement and negotiation memorandum.

In response to Report No. DODIG-2017-055, DCMA stated that it would provide training to all contracting officers and supervisors covering the requirements for properly distributing the negotiation memorandum and indirect cost rate agreement. In conjunction with Defense Acquisition University, DCMA completed the development of the training in October 2018, and began providing the training to its contracting officers and supervisors. Therefore, we are not making any additional recommendations in this report. However, we request that DCMA make the completion of the training a priority. The previous recommendation will remain open until DCMA provides evidence that the contracting officers and supervisors have received the training. This report demonstrates an ongoing failure of DCMA contracting officers to distribute negotiation memorandums and indirect cost agreements and maintain evidence of the distribution in accordance with the FAR. Once completed, the training should help ensure that contractors comply with the FAR requirement to distribute these important negotiation documents.

## Conclusion

For 17 of the 35 audit reports, the contracting officers did not maintain evidence that the negotiation memorandum and indirect cost rate agreement were distributed to other contracting officials affected by the negotiation, as FAR 42.706 and DCMA Instruction 125 require. In addition, for 9 of the 35 audit reports, the contracting officers could not demonstrate that they had furnished a copy of the negotiation memorandum and indirect cost rate agreement to DCAA. Furthermore, of the contracting officers who could not demonstrate that they had distributed the documents, 12 of them acknowledged that they had not actually distributed the documents.

Prompt distribution of the negotiation memorandum and indirect cost rate agreement are essential because affected Government agencies use these documents to determine final allowable costs on Government contracts.

In response to Report No. DODIG-2017-055, DCMA has developed refresher training on the requirements for distributing negotiation memorandums and indirect rate agreements. DCMA is in the process of conducting the refresher training to all contracting officers and supervisors.

## Appendix A

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### Scope and Methodology

We conducted this evaluation from October 2017 through December 2018 in accordance with the “Quality Standards for Inspections and Evaluations” published in January 2012 by the Council of Inspectors General on Integrity and Efficiency. Those standards require that we adequately plan the evaluation to ensure that objectives are met and that we perform the evaluation to obtain sufficient, competent, and relevant evidence to support the findings, 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.

To accomplish our evaluation objective, we:

- reviewed relevant parts of the FAR, DoD Instructions, and DCMA procedures addressing contractor claimed executive compensation;
- judgmentally selected a reasonable cross-section of 35 DCAA audit reports issued between July 2014 and September 2016, which collectively questioned \$58.1 million in claimed executive compensation;
- gained an understanding of the DCAA questioned costs and associated working papers;
- interviewed DCAA audit staff to clarify our understanding of the DCAA questioned executive compensation;
- gathered and analyzed DCMA records of contracting officer actions taken on the DCAA questioned executive compensation;
- interviewed DCMA contracting officials involved in taking action on the questioned executive compensation; and
- evaluated DCMA contracting officer actions for compliance with the FAR, DoD Instruction 7640.02, and DCMA instructions.

### Use of Computer-Processed Data

In selecting the 35 DCAA audit reports, we relied on a computerized DCAA list of audit reports issued between July 2014 and September 2016. DCAA generated the list from its management information system. We tested the accuracy of the list by tracing the 35 selected reports to source documents. However, we did not test the list for completeness.

## Prior Coverage

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

### **DoD OIG**

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

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

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

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

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

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

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

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

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

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

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

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

## Appendix B

### Inadequate Rationale and Contributing Factors

Count	DCAA Audit Report	Inadequate Rationale				Contributing Factors	
		RoR Factor	Locality Pay	Grouping Executives	Other Areas	No Legal Review	No DCAA Opinion
1	6331-2010A10100014						
2	6321-2009M10100006				X	X	X
3	6631-2010C10100001						
4	6431-2011P10100026						
5	6221-2008U10100013				X	X	
6	6431-2007C10100027						
7	1211-2008X10100017	X	X			X	X
8	1661-2008H10100003						
9	1201-2011J10100312		X			X	
10	4281-2009V10100031		X	X		X	
11	4371-2009D10100001						
12	3151-2011U10100001	X				X	
13	6821-2009G10100001			X		X	X
14	1311-2009J10100003		X			X	
15	1701-2008E10100163						
16	2151-2009P10100010		X			X	
17	4371-2009M10100018	X				X	X
18	6281-2012H10100001	X				X	X
19	6821-2007F10100001			X		X	
20	3231-2009L10100001						
21	6151-2010F10100062						
22	1661-2011C10100001						
23	2171-2010W10100001						
24	3231-2009L10100003						
25	6141-2010F10100006						
26	6161-2008E10100001				X	X	
27	6281-2008H10100001				X	X	X
28	6281-2010H10100001	X				X	X
29	6631-2008C10100001			X		X	
30	1661-2008X10100012						

*Inadequate Rationale and Contributing Factors (cont'd)*

Count	DCAA Audit Report	Inadequate Rationale				Contributing Factors	
		RoR Factor	Locality Pay	Grouping Executives	Other Areas	No Legal Review	No DCAA Opinion
31	6711-2007E10100002	X	X			X	
32	2211-2009S10100001	X	X	X		X	
33	2211-2010S10100001						
34	3171-2011T10100001						
35	3171-2011T10100003						
	<b>Total</b>	<b>7</b>	<b>7</b>	<b>5</b>	<b>4</b>	<b>18</b>	<b>7</b>

## Appendix C

### Negotiation Documents Not Distributed

Count	DCAA Audit Report	Documents Not Distributed to Affected Contracting Officials	Documents Not Distributed to DCAA
1	6331-2010A10100014		X
2	6321-2009M10100006		
3	6631-2010C10100001		
4	6431-2011P10100026		
5	6221-2008U10100013	X	
6	6431-2007C10100027		
7	1211-2008X10100017	X	
8	1661-2008H10100003	X	
9	1201-2011J10100312		
10	4281-2009V10100031		
11	4371-2009D10100001		X
12	3151-2011U10100001	X	X
13	6821-2009G10100001		
14	1311-2009J10100003		
15	1701-2008E10100163		X
16	2151-2009P10100010		
17	4371-2009M10100018		
18	6281-2012H10100001	X	X
19	6821-2007F10100001		
20	3231-2009L10100001	X	
21	6151-2010F10100062	X	X
22	1661-2011C10100001	X	X
23	2171-2010W10100001		
24	3231-2009L10100003	X	
25	6141-2010F10100006		
26	6161-2008E10100001		
27	6281-2008H10100001	X	
28	6281-2010H10100001	X	
29	6631-2008C10100001		
30	1661-2008X10100012	X	X

*Negotiation Documents Not Distributed (cont'd)*

Count	DCAA Audit Report	Documents Not Distributed to Affected Contracting Officials	Documents Not Distributed to DCAA
31	6711-2007E10100002	x	X
32	2211-2009S10100001	X	
33	2211-2010S10100001	X	
34	3171-2011T10100001	X	
35	3171-2011T10100003	X	
	<b>Total</b>	<b>17</b>	<b>9</b>

# Management Comments

## Defense Contract Management Agency



### DEFENSE CONTRACT MANAGEMENT AGENCY

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

MAR 03 2019

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: DCMA Response to DoDIG Draft Report "Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency," February 1, 2019 (Project No. D2017-DAPOCF-0195.000)

Attached is the Defense Contract Management Agency's response to the subject DoDIG Draft Report dated February 1, 2019. Responses address DCMA's concurrence with the recommendations and actions that will be implemented to address recommendation A.1 (a & b) and recommendation A.2 (a & b) of subject report.

The point of contact for this response is [REDACTED]

A handwritten signature in black ink, appearing to read "D. Lewis", written over a white background.

David H. Lewis  
VADM, USN  
Director

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

Link(s):  
None

## Defense Contract Management Agency (cont'd)

"Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency," February 1, 2019 (Project No. D2017-DAPOCF-0195.000)

### Recommendation A.1

**We recommend that the Defense Contract Management Agency Director develop procedures and processes for addressing Defense Contract Audit Agency findings on executive compensation by implementing either:**

- a. **A program whereby contracting officers may seek advice and assistance from qualified personnel with extensive knowledge on executive compensation, or**
- b. **Guidelines and training for contracting officers that address executive compensation concepts and approaches for taking action on executive compensation audit findings in an appropriate and consistent manner.**

### DCMA Response:

DCMA concurs with these recommendations and has a phased approach to address the noted deficiencies. The immediate solution will be to advertise the usage of the Indirect Cost Control (ICC) email box, which is currently being monitored by personnel who can assist with general questions and provide guidance on executive compensation. Additionally, existing training slides covering executive compensation will be posted to the appropriate policy resource page with agency-wide access by March 15, 2019. The Contract Directorate Policy Division (DCMA-AQC) will notify all Contract Directors (CDs), at the next monthly CD teleconference, of the existing in-box and state where posted training is located. DCMA-AQC will then formally notify all Contracting Officers (COs) of these resources via an Agency-wide memo (C-note) expected to be released by March 31, 2019. The long-term solution is to conduct a joint (Cost and Pricing Component and General Counsel) training session to educate COs on proper practices and techniques when evaluating and determining executive compensation. The Estimated Completion Date (ECD) for this training is September 30, 2019.

### Recommendation A.2

**We recommend that the Defense Contract Management Agency Director provide refresher training to contracting officers on the requirements to:**

- a. **Consult with Agency legal counsel when their disagreement with an audit finding is based on an interpretation of a law or regulation, in accordance with DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," April 15, 2015, and**
- b. **Obtain a Defense Contract Audit Agency opinion on additional information received from contractors after audit report issuance, in accordance with DCMA Instruction 125, "Final Overhead Rates," April 21, 2014.**

## Defense Contract Management Agency (cont'd)

“Evaluation of Defense Contract Management Agency Contracting Officer Actions on DoD Contractor Executive Compensation Questioned by the Defense Contract Audit Agency,”  
February 1, 2019 (Project No. D2017-DAPOCF-0195.000)

**DCMA Response:**

DCMA concurs with these recommendations and will reinforce coverage in Agency policy. First, DCMA-AQC will remind all DCMA Contract Directors of required policy coverage at the next monthly teleconference. Second, DCMA-AQC will formally remind the COs of these requirements via an Agency-wide memo (C-note) to be released by March 31, 2019. Third and long term, the solution is to train Contracting Officer personnel via the aforementioned joint training session, which will address the above noted deficiencies. As previously noted, the ECD for this training is September 30, 2019.

## Acronyms and Abbreviations

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<b>ASBCA</b>	Armed Services Board of Contract Appeals
<b>DCAA</b>	Defense Contract Audit Agency
<b>DCMA</b>	Defense Contract Management Agency
<b>FAR</b>	Federal Acquisition Regulation
<b>OIG</b>	Office of Inspector General
<b>ROR</b>	Range of Reasonableness
<b>VP</b>	Vice President

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