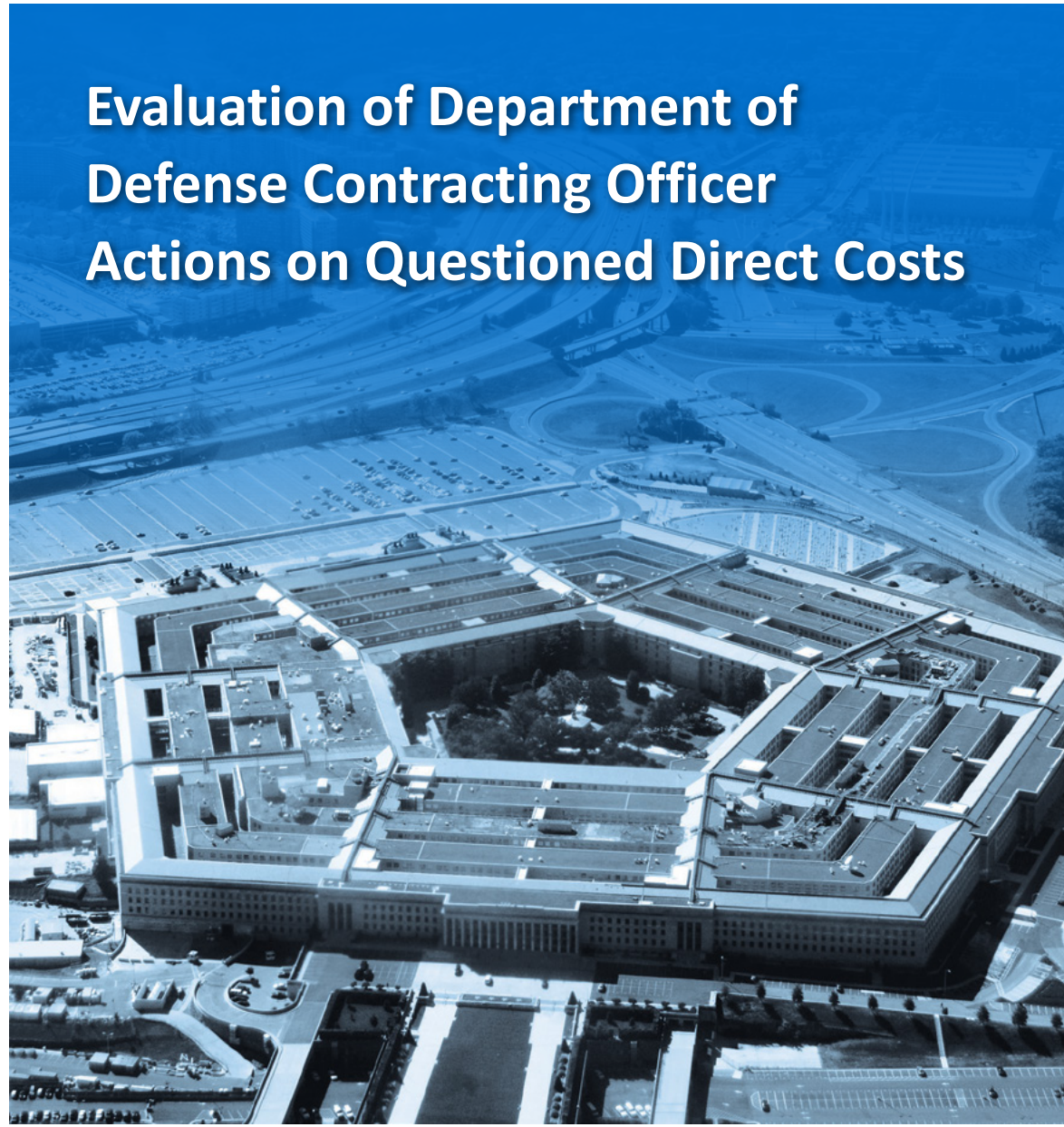




INSPECTOR GENERAL

U.S. Department of Defense

JANUARY 21, 2021



Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





Results in Brief

Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs

January 21, 2021

Objective

The objective of this evaluation was to determine whether the actions taken by DoD contracting officers on questioned direct costs reported by the Defense Contract Audit Agency (DCAA) complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy.

Additionally, we followed up on the actions taken by DoD contracting officers in response to prior recommendations in DoD OIG Report No. DODIG-2017-055. The prior DoD OIG report identified eight DCAA audit reports where the contracting officers took no action on \$304.8 million in questioned direct costs.

Background

The DCAA performs incurred cost audits to examine a DoD contractor's claimed indirect and direct costs incurred on Government contracts to determine whether the claimed costs are allowable in accordance with contract terms and the FAR. When a DCAA auditor finds any indirect and direct claimed costs that do not comply with the contract terms and the FAR, the DCAA reports the costs as questioned because the costs are considered unallowable on Government contracts. The DCAA issues the report to a DoD contracting officer who is responsible for making a final determination on whether the DoD contractor's claimed indirect and direct costs are allowable in accordance with contract terms and the FAR.

Background (cont'd)

DoD Instruction 7640.02 and DCMA policy require DCMA divisional administrative contracting officers (DACOs), who are usually the primary recipients of DCAA incurred cost audit reports, to settle (make a final determination on the allowability of the claimed costs) any questioned indirect costs identified in DCAA audit reports and prepare a final indirect cost rate agreement.¹

However, according to DCMA Manual 2201-03, DCMA administrative contracting officers (ACOs) must settle DCAA questioned direct costs.² The DCMA DACO must coordinate with DCMA ACOs, other DoD Component contracting officers, or other Government agency contracting officers who have the responsibility for settling any questioned direct costs identified in DCAA incurred cost audit reports.

DoD Instruction 7640.02 and DCMA policy also require the DCMA contracting officer to keep the DCAA audit report open in the Contract Audit Follow-Up (CAFU) system until all questioned costs (including questioned direct costs) are settled. The DoD Components use the CAFU system to track and record actions taken to settle DCAA audit reports. For 25 of the 26 DCAA reports we selected, DCMA DACOs were responsible for coordinating with the DCMA ACOs or other contracting officers to obtain a settlement on the questioned direct costs. The DCMA DACOs were then responsible for closing the associated CAFU system record after they completed all required actions, including the completion of a negotiation memorandum, which in part explains the basis for settling DCAA questioned costs.

Findings

For 12 of 26 DCAA audit reports, DCMA contracting officers did not comply with DoD Instruction 7640.02 and DCMA policy because they did not settle, or coordinate the

¹ DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," April 15, 2015.

² DCMA Manual 2201-03, "Final Indirect Cost Rates," February, 14, 2019.



Results in Brief

Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs

Findings (cont'd)

settlement of, \$231.5 million in questioned direct costs. DCMA contracting officers did not comply with DoD Instruction 7640.02 and DCMA policy because:

- The DCMA lacks adequate guidance for identifying and coordinating with other contracting officers who are responsible for settling questioned direct costs;
- DCMA supervisors and the DCMA OIG did not provide effective oversight of the DCMA DACOs' actions for settling questioned direct costs; and
- DCMA Manual 2201-03 states that DCMA ACOs must settle questioned direct costs.

As a result of not settling the DCAA questioned direct costs, DCMA contracting officers may have reimbursed DoD contractors up to \$231.5 million in costs that may be unallowable on Government contracts in accordance with the FAR.

Additionally, three recommendations from DoD OIG Report No. DODIG-2017-055 remain open because the DCMA contracting officers assigned to three of the eight audit reports have not yet settled \$98.1 million of the \$304.8 million in questioned direct costs reported by the DCAA. The DCMA contracting officers stated that they did not settle, or coordinate the settlement of, the questioned direct costs because they experienced difficulties in determining the other contracting officers responsible for settling the questioned direct costs. As a result, DCMA contracting officers may have reimbursed DoD contractors up to \$98.1 million in unallowable costs.

Recommendations

Among the six recommendations for DCMA, we recommend that the Defense Contract Management Agency Director:

- Require the DCMA DACOs to coordinate the settlement of the \$231.5 million in questioned costs that have not been settled.
- Determine whether to revise DCMA policy to allow DCMA DACOs to settle questioned direct costs.

In addition, we recommend that the Defense Pricing and Contracting (DPC) Principal Director issue guidance to the DoD Components to clarify who has the authority and responsibility for settling questioned direct costs.

Management Comments and Our Response

The DCMA Director disagreed with one element of our findings, but agreed with the six recommendations for the DCMA. In addition, the DPC Principal Director partially agreed with the one recommendation for the DPC.

The DCMA Director did not agree with our finding that the FAR grants DCMA contracting officers the authority to settle or negotiate DCAA questioned direct costs. The DCMA Director stated that DCMA ACOs and DACOs are limited to establishing final indirect cost and billing rates.³ We disagree with the DCMA Director that the

³ FAR Subpart 42.3, "Contract Administration Office Functions."



Results in Brief

Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs

Comments (cont'd)

FAR limits DCMA ACOs and DACOs to establishing final indirect cost and billing rates. As stated by the DPC, which establishes DoD acquisition policy, DCMA contracting officers (including DACOs) have the authority to settle questioned direct costs as part of their administrative responsibilities in establishing indirect rates in accordance with the FAR.

The DCMA Director agreed with the six recommendations for the DCMA. Specifically, the Director agreed to have the DCMA DACOs reopen the CAFU records and coordinate the settlement of the \$231.5 million in questioned costs that have not been settled. The DCMA Director also agreed to provide the DCMA contracting officers and supervisors who were responsible for settling the questioned costs with additional training. The DCMA Director further agreed to update DCMA policy to clarify the roles of the various types of DoD contracting officers in settling questioned direct costs, consistent with guidance provided by the DPC.

The DPC Principal Director stated that he partially agreed with the one recommendation to issue guidance to the DoD Components, which clarifies who has the authority to settle direct questioned costs. The DPC Principal Director agreed to consider issuing clarifying guidance if he determines that it will be useful to do so. In addition, the DPC Principal Director will consider a revision to the Defense Federal Acquisition Regulation Supplement to clarify DoD contracting officer roles and their authority in settling questioned direct costs.

We determined that the comments from the DCMA Director and the DPC Principal Director addressed the specifics of all seven recommendations. Therefore, the seven recommendations are resolved but will remain open until we verify that the agreed-upon actions to implement the recommendations are completed.

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

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Defense Contract Management Agency Director	None	A.1, A.2, A.3, A.4, A.5, A.6	None
Defense Pricing and Contracting Principal Director	None	A.7	None

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

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



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

January 21, 2021

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
PRINCIPAL DIRECTOR, DEFENSE PRICING AND CONTRACTING
NAVAL INSPECTOR GENERAL

SUBJECT: Evaluation of DoD Contracting Officer Actions on Questioned Direct Costs
(Report No. DODIG-2021-047)

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

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

If you have any questions, please contact [REDACTED]
[REDACTED]

A handwritten signature in black ink, appearing to read "Randolph R. Stone", is located below the contact information.

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

Contents

Introduction

Objective.....	1
Background.....	1

Finding A. DCMA Contracting Officers' Actions on Questioned Direct Costs Did Not Comply With DoD Instruction 7640.02 and DCMA Policy for 12 of 26 Audit Reports..... 5

DCMA Contracting Officers Did Not Comply With DoD Instruction 7640.02 and DCMA Manual 2201-03 on 12 of the 26 DCAA Audit Reports.....	6
Three Factors Contributed to DCMA Contracting Officers Not Complying With DoD Instruction 7640.02 and DCMA Manual 2201-03	9
DCMA Contracting Officers May Have Reimbursed DoD Contractors Up To \$231.5 Million in Unallowable Direct Costs.....	13
Defense Contract Management Agency Comments on the Finding.....	14
Our Response.....	14
Recommendations, Management Comments, and Our Response.....	15

Finding B. DCMA DACOs Have Not Taken All Actions Required to Settle the Questioned Direct Costs From Three of Eight Audit Reports, as a Previous DoD Office of Inspector General Report Recommended..... 20

The DCMA Has Not Taken All Actions Required to Settle \$98.1 Million in Questioned Direct Costs From Three of the Eight Audit Reports, as a DoD Office of Inspector General Report Recommended.....	21
DCMA DACOs Have Not Completed Actions Required to Settle \$98.1 Million Because of Difficulties With Identifying Who Had Responsibility to Settle the Questioned Direct Costs.....	24
DCMA Contracting Officers May Have Reimbursed up to \$98.1 Million in Unallowable Costs on Government Contracts.....	24
The Recommendations in Report No. DODIG-2017-055 Remain Open.....	25

Contents (cont'd)

Appendixes

Appendix A. Scope and Methodology.....	26
Use of Computer-Processed Data.....	28
Use of Technical Assistance.....	28
Prior Coverage.....	28
Appendix B.....	30
Appendix C.....	32
Appendix D.....	34

Management Comments

Defense Contract Management Agency Director.....	36
Defense Pricing and Contracting Principal Director.....	42

Acronyms and Abbreviations.....	43
--	-----------



Introduction

Objective

The objective of this evaluation was to determine whether the actions taken by DoD contracting officers on questioned direct costs reported by the Defense Contract Audit Agency (DCAA) complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy.

Additionally, we followed up on the actions taken by DoD contracting officers in response to DoD OIG Report No. DODIG-2017-055.⁴ In this report, we recommended that the DoD contracting officers assigned to eight DCAA audit reports take action to settle \$304 million in questioned direct costs. Appendix A contains details of our scope and methodology.

Background

The FAR is the primary regulation that all Federal Executive agencies follow to acquire supplies and services. The Government pays contractors in amounts determined to be allowable by the contracting officer in accordance with FAR subpart 31.2.⁵ DoD contractors incur both direct and indirect costs in the performance of a Government contract. Direct costs benefit one contract, while indirect costs benefit two or more contracts. Examples of direct costs include labor, travel, material, and services that benefit a single contract. Examples of indirect costs include office rent, utilities, and employee benefits that benefit more than one contract.

Defense Contract Audit Agency Performs Audits of Contractor Claimed Direct and Indirect Costs

The DCAA operates in accordance with DoD Directive 5105.36 and reports to the Under Secretary of Defense (Comptroller)/Chief Financial Officer, DoD.⁶ On behalf of the DoD, the DCAA performs several types of contract audits, including incurred cost audits. The objective of an incurred cost audit is to determine if a DoD contractor's incurred direct and indirect costs claimed on Government contracts are allowable in accordance with contract terms and the FAR. When a DCAA auditor finds any direct and indirect costs that do not comply with the contract terms and FAR 31.2, the DCAA auditor questions the costs as unallowable. For all DCAA incurred cost audit reports issued in FY 2019, the DCAA questioned a total of \$2.8 billion in DoD contractor claimed direct and indirect costs.

⁴ 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.

⁵ FAR Subpart 31.2, "Contract with Commercial Organizations."

⁶ DoD Directive 5105.36, "Defense Contract Audit Agency," January 4, 2010.

DoD Instruction 7640.02 Establishes Recordkeeping Requirements for DoD Contracting Officer Actions on Contract Audit Reports

DoD Instruction 7640.02 establishes recordkeeping requirements for DoD contracting officer actions on contract audit reports, including DCAA incurred cost audit reports.⁷ In support of the recordkeeping requirements, the Defense Contract Management Agency (DCMA) maintains an automated database referred to as the Contract Audit Follow-Up (CAFU) system that DoD Components use to track and record actions taken to settle DCAA audit reports. The CAFU system creates a record for each unique DCAA report number.⁸ DoD contracting officers must address all DCAA audit report findings and recommendations and prepare a negotiation memorandum before they close the associated record in the CAFU system. The negotiation memorandum provides a written record of the DoD contracting officer's decision on the DCAA audit report and includes the rationale for not upholding any of the DCAA reported questioned costs.

DoD Instruction 7640.02 requires DoD contracting officers to determine whether they agree with each DCAA audit finding or recommendation and, if they do not, document their rationale for any disagreement with the DCAA in the negotiation memorandum. DoD Instruction 7640.02 also requires DoD contracting officers to complete their actions on a DCAA audit report ("settle" a DCAA audit report) within 12 months. A DCAA incurred cost audit report is considered settled when the DoD contracting officer has prepared a negotiation memorandum addressing all reported findings and no further actions can be reasonably anticipated. If the DoD contracting officer does not settle the DCAA audit report within 12 months, DoD Instruction 7640.02 requires the DoD contracting officer to document the actions taken to achieve settlement at least monthly.

Defense Contract Management Agency Is Normally Responsible for Taking Action on DCAA Audit Reports

The DCMA operates in accordance with DoD Directive 5105.64 and functions under the authority, direction, and control of the Under Secretary of Defense for Acquisition and Sustainment.⁹ As the designated contract administration office in accordance with FAR subpart 42.3, the DCMA is responsible for taking action on most DCAA audit reports.¹⁰ For DCAA incurred cost audit reports, the DCMA is generally responsible for determining whether the DoD contractor's claimed

⁷ DoD Instruction 7640.02, "Policy for Follow-up on Contract Audit Reports," April 15, 2015.

⁸ The DCAA may issue an incurred cost audit report that covers multiple contractor fiscal years. In those cases, the report includes more than one unique DCAA audit number. We counted each DCAA audit number as a separate report.

⁹ DoD Directive 5105.64, "Defense Contract Management Agency," January 10, 2013.

¹⁰ FAR Subpart 42.3, "Contract Administration Office Functions." Contract administration office means an office that performs (1) assigned post-award functions related to the administration of contracts, and (2) assigned pre-award functions.

indirect and direct costs are allowable in accordance with contract terms and FAR subpart 31.2 and for negotiating a final indirect cost rate agreement that will be used to close the contractor's contracts.¹¹

DCMA Manual 2201-03 reiterates the requirements of FAR subpart 42.3 and establishes policies and assigns responsibility for settling final indirect cost rates and questioned direct costs.¹² DCMA Manual 2201-03 requires DCMA divisional administrative contracting officers (DACOs), who are usually the primary recipients of a DCAA incurred cost audit report, to settle any questioned indirect costs and prepare the final indirect cost rate agreement. According to DCMA Manual 2201-03, DCMA administrative contracting officers (ACOs) must settle any questioned direct costs. DCMA Manual 2201-03 does not indicate whether DCMA DACOs have the authority to settle direct costs. However, the Manual does state that the DCMA DACO must coordinate and obtain settlement results from DCMA ACOs, DoD Component contracting officers, and Government agency contracting officers, who have the responsibility for settling DCAA questioned direct costs relating to one or more of their contracts. The DCMA DACO and DCMA ACO are collectively referred to in this report as DCMA contracting officers.

DCMA Manual 2201-04 reiterates the requirements of DoD Instruction 7640.02 for settling DCAA audit reports and emphasizes that DCMA contracting officers must include sound rationale in the negotiation memorandum when they disagree with audit findings and recommendations.¹³ DCMA Manual 2201-04 also requires the DCMA contracting officer to keep the DCAA audit report open in the CAFU system until all questioned costs (including questioned direct costs) are settled.

Defense Pricing and Contracting Develops and Implements Department of Defense Procurement and Acquisition Policy

The Defense Pricing and Contracting (DPC), within the Office of the Under Secretary of Defense for Acquisition and Sustainment, is responsible for developing and implementing contracting, procurement, and acquisition policy within the DoD in accordance with DoD Instruction 5000.35.¹⁴ The DPC executes amendments to the Defense Federal Acquisition Regulation Supplement (DFARS) and the companion

¹¹ FAR Subpart 31.2, "Contracts with Commercial Organizations." An indirect cost rate agreement refers to a written understanding between the contractor and the Government on indirect cost rates that the Government uses to close out cost-reimbursement contracts.

¹² DCMA Manual 2201-03, "Final Indirect Cost Rates," February, 14, 2019. This DCMA Manual replaces DCMA Instruction 125, "Final Overhead Rates," November 8, 2016. The requirements discussed in this report remain the same between the two documents.

¹³ DCMA Manual 2201-04, "Contract Audit Follow Up," March 3, 2019. This DCMA Manual replaces DCMA Instruction 126, "Contract Audit Follow Up," August 22, 2013, as amended. The requirements discussed in this report remain the same between the two documents.

¹⁴ DoD Instruction 5000.35, "Defense Acquisition Regulations (DAR) System," August 31, 2018.

resource, DFARS Procedures, Guidance, and Information. Additionally, the DPC Principal Director is a member of the FAR Council and collaborates with the FAR Council staff members on the direction and promulgation of Government-wide procurement policy and regulatory activities.

We Selected 26 Defense Contract Audit Agency Audit Reports That Identified Questioned Direct Costs and We Followed Up on Previous Recommendations

We selected 26 DCAA audit reports from a universe of 68 DCAA audit reports that each questioned over \$1 million in direct costs and were reported as settled in the CAFU system by DoD contracting officers between October 2017 and September 2018. The DCAA issued the 26 DCAA audit reports for settlement between February 2006 and September 2017. In total, the 26 DCAA audit reports identified \$597.4 million in questioned direct costs because the auditors determined that the costs were unallowable in accordance with FAR subpart 31.2. Common reasons for the DCAA questioning the direct costs included instances where contractors did not provide sufficient supporting documentation of the costs or where DCAA auditors determined that the costs were unreasonable in accordance with FAR 31.201-3.¹⁵

For 25 of the 26 DCAA reports we evaluated, DCMA DACOs were responsible for coordinating the settlement of the questioned direct costs and closing the CAFU system record. For the remaining DCAA audit report we evaluated, a Navy contracting officer was responsible for settling the questioned direct costs and closing the CAFU system record.

In addition, we performed a follow-up evaluation of Recommendations A.1, A.2, D.1, and E.1 from DoD OIG Report No. DODIG-2017-055. In Finding A of Report No. DODIG-2017-055, we determined that DoD contracting officers did not take any action on eight DCAA audit reports that questioned \$304.8 million in direct costs, and we recommended that the DoD contracting officers take the actions necessary to settle the costs.

¹⁵ FAR 31.201-3, "Determining Reasonableness."

Finding A

DCMA Contracting Officers' Actions on Questioned Direct Costs Did Not Comply With DoD Instruction 7640.02 and DCMA Policy for 12 of 26 Audit Reports

For 12 of 26 DCAA audit reports, DCMA contracting officers did not comply with DoD Instruction 7640.02 and DCMA policy because they did not settle, or coordinate the settlement of, \$231.5 million in questioned direct costs. In addition, the DCMA DACOs closed the associated records in the CAFU system for the 12 audit reports even though the \$231.5 million of the \$258 million in reported questioned direct costs were not settled. Specifically, of the 12 DCAA audit reports, the DCMA contracting officers did not settle, or coordinate the settlement of:

- any of the \$193.1 million in questioned direct costs identified in 2 of the 12 audit reports; and
- \$38.4 million of \$64.9 million in questioned direct costs identified in 10 of the 12 audit reports.

The DCMA DACOs received the 12 audit reports for settlement from the DCAA between February 2006 and September 2017 (56 months ago on average, as of August 1, 2020). Although DoD Instruction 7640.02 requires contracting officers to settle a DCAA audit report within 12 months, the DCMA contracting officers still have not settled, or coordinated the settlement of, the \$231.5 million of the \$258 million in questioned direct costs identified within the 12 audit reports.

For the remaining 14 of 26 DCAA audit reports, the DoD contracting officers settled the \$339.4 million in questioned direct costs and closed the CAFU system record in compliance with FAR subpart 31.2, DoD Instruction 7640.02, and agency policy, including the one audit report issued to the Navy that we selected for review.

We identified the following three factors that contributed to DCMA contracting officers not complying with DoD Instruction 7640.02 and DCMA policy for 12 of 26 DCAA audit reports:

- the DCMA lacks adequate guidance for identifying and coordinating with other contracting officers who are responsible for settling questioned direct costs;
- DCMA supervisors and the DCMA OIG did not provide effective oversight of the DCMA DACOs' actions for settling questioned direct costs; and
- DCMA Manual 2201-03 states that DCMA ACOs must settle questioned direct costs.

As a result, DCMA contracting officers may have reimbursed DoD contractors up to \$231.5 million in costs that may be unallowable on Government contracts according to FAR subpart 31.2. Appropriately addressing questioned direct costs in a timely manner by DCMA contracting officers is important for ensuring that the Government does not reimburse DoD contractors for costs that are unallowable.

DCMA Contracting Officers Did Not Comply With DoD Instruction 7640.02 and DCMA Manual 2201-03 on 12 of the 26 DCAA Audit Reports

For 12 of 26 DCAA audit reports we reviewed, DCMA contracting officers did not comply with the requirements of DoD Instruction 7640.02, Enclosure 3, paragraph 3, and DCMA Manual 2201-03, Section 3.11, because they did not settle, or coordinate the settlement of, \$231.5 million of the \$597.4 million in questioned direct costs. The DCMA DACOs closed the CAFU system records indicating that all required actions had been completed on the audit reports, including the settlement of the questioned direct costs. However, the DCMA contracting officers did not settle, or coordinate the settlement of:

- \$193.1 million in questioned direct costs identified in 2 audit reports; and
- \$38.4 million of \$64.9 million of the questioned direct costs identified in 10 audit reports.

In addition, as of August 1, 2020, 56 months on average had passed since the DCMA DACOs received the 12 DCAA audit reports, which significantly exceeded the DoD Instruction 7640.02 requirement to settle DCAA audit reports within 12 months. Appendix C contains details on the number of months elapsed between DCAA audit report issuance date and the contracting officer's settlement of the questioned direct costs.

For the remaining 14 of 26 DCAA audit reports, the DCMA and Navy contracting officers settled all questioned direct costs, worth \$339.4 million, identified in the audit reports and closed the associated CAFU system records in compliance with the FAR subpart 31.2, DoD Instruction 7640.02, DCMA Manual 2201-03, and Department of the Navy, Supervisor of Shipbuilding, Conversion and Repair, Instruction 4330.27F.¹⁶

¹⁶ Supervisor of Shipbuilding, Conversion and Repair, Instruction 4330.27F, "Follow-up on DCAA Contract Audit Reports," October 21, 1994.

The DCMA DACO Did Not Take Any Action on \$193.1 Million in Questioned Direct Costs for Two Audit Reports

For two DCAA audit reports, the DCMA DACO did not take action on any of the \$193.1 million in questioned direct costs. Even though the DCMA DACO did not take any action on the questioned direct costs, she closed the CAFU system record for the two audit reports. DoD Instruction 7640.02, Enclosure 3, paragraph 3, requires DoD contracting officers to address all audit findings and recommendations before the DoD contracting officer closes the CAFU system record. Table 1 shows the amount of unsettled questioned direct costs by DCAA audit report number.

Table 1. Unsettled Questioned Direct Costs by DCAA Audit Report

	DCAA Audit Report Number	DCAA Questioned Direct Costs	Settled Questioned Direct Costs	Unsettled Questioned Direct Costs
1	9841-2009C10100001	\$88,502,086	\$0	\$88,502,086
2	9841-2010C10100001	104,629,898	0	104,629,898
	Total	\$193,131,984	\$0	\$193,131,984

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

Although the DCMA DACO received the two DCAA audit reports on March 10, 2016, the \$193.1 million of questioned direct costs remained unsettled as of August 1, 2020. According to DCMA Manual 2201-03, Section 3.11, the DCMA DACO is responsible for:

- coordinating with any DoD contracting officer, or other Government agency, that has settlement responsibility over a portion of the questioned direct costs; and
- keeping the audit report open in the CAFU system until the DCMA DACO receives the settlement results for all questioned direct costs.

However, for these two audit reports, the DCMA DACO did not coordinate with the other contracting officers who were responsible for settling the questioned direct costs. Instead, the DCMA DACO settled only the indirect costs for both reports and closed the records in the CAFU system without taking any action on the questioned direct costs. The DCMA DACO stated that she provided the two DCAA audit reports to the DCMA ACO for direct cost settlement. However, we found no evidence that DCMA DACO had actually sent the audit reports to the DCMA ACO. The DCMA ACO stated that he did not receive the two DCAA audit reports for direct cost settlement.

DCMA Contracting Officers Did Not Settle \$38.4 Million of the \$64.9 Million in Questioned Direct Costs for 10 Audit Reports

For 10 of 26 DCAA audit reports we reviewed, DCMA contracting officers did not settle \$38.4 million of \$64.9 million in questioned direct costs, even though the DCMA DACOs closed the CAFU system record indicating that they had completed all required actions. Table 2 shows the amount of settled and unsettled questioned direct costs by DCAA audit report number.

Table 2. Settled and Unsettled Questioned Direct Costs by DCAA Audit Report Number

	DCAA Audit Report Number	DCAA Questioned Direct Costs	Settled Questioned Direct Costs	Unsettled Questioned Direct Costs
1	4371-2009M10100018	\$13,656,359	\$2,845,945	\$10,810,414
2	4371-2010C10100001	4,642,909	2,475,007	2,167,902
3	2631-2010D10100001	13,586,159	2,577,871	11,008,288
4	2631-2011D10100001	10,777,531	1,140,295	9,637,236
5	3211-2010D10100001S1	1,080,679	1,033,934	46,745
6	4371-2007M10100010	1,731,929	1,608,165	123,764
7	4371-2008M10100010	3,247,171	3,091,837	155,334
8	6161-2008G10100001	5,291,950	5,227,647	64,303
9	6161-2009G10100002	4,619,491	1,895,129	2,724,362
10	6741-2009Q10100001	6,303,155	4,680,463	1,622,692
	Total	\$64,937,333	\$26,576,293	\$38,361,040

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

Although the DCMA DACOs received the 10 DCAA audit reports between September 2014 and April 2017, the \$38.4 million remained unsettled as of August 1, 2020. The DCMA DACOs either did not coordinate the settlement or did not wait for the settlement results for a portion of the questioned direct costs before closing the CAFU system records. For example, the DCAA issued Audit Report Numbers 4371-2009M10100018 and 4371-2010C10100001 to a DCMA DACO who was required to coordinate with other contracting officers responsible for the settlement of \$18.3 million in questioned direct costs. However, the DCMA DACO did not coordinate with other contracting officers responsible for settling \$13 million of the \$18.3 million in questioned direct costs and closed the associated records in the CAFU system. A DCMA ACO took action to settle the remaining \$5.3 million of \$18.3 million questioned direct costs for which he had settlement responsibility. The DCMA DACO's actions did not comply with DCMA Manual 2201-03, which requires a DACO to coordinate with other

contracting officers responsible for the settlement of the questioned direct costs. In addition, the DCMA DACO did not keep the CAFU records open until all costs were settled, as DoD Instruction 7640.02 requires. The DCMA DACO responsible for taking action on Audit Report Numbers 4371-2009M10100018 and 4371-2010C10100001 left the agency and the newly assigned DCMA DACO has not coordinated the settlement of the questioned direct costs because the CAFU system records were closed.

For the remaining eight audit reports, the DCMA DACOs similarly closed the records in the CAFU system and did not take action to settle \$25.4 million in questioned direct costs. Therefore, we concluded that the DCMA DACOs did not comply with DoD Instruction 7640.02 and DCMA Manual 2201-03 for the 10 audit reports.

Three Factors Contributed to DCMA Contracting Officers Not Complying With DoD Instruction 7640.02 and DCMA Manual 2201-03

We identified the following three factors that contributed to DCMA contracting officers not ensuring the settlement of millions of dollars in DCAA questioned direct costs.

- The DCMA lacks adequate guidance for identifying and coordinating with other contracting officers who are responsible for settling questioned direct costs.
- DCMA supervisors and the DCMA OIG did not provide effective oversight of DCMA DACO actions on the settlement of questioned direct costs.
- DCMA Manual 2201-03 states that DCMA ACOs must settle questioned direct costs.

DCMA Lacks Adequate Guidance for Identifying and Coordinating With DoD Contracting Officers Who Are Responsible for Settling Questioned Direct Costs

The DCMA lacks adequate guidance for helping DCMA DACOs identify and coordinate with DoD contracting officers who are responsible for settling questioned direct costs. For 9 of the 26 audit reports we selected, the DCMA DACOs who received the DCAA audit reports experienced difficulties in:

- identifying the DoD contracting officers authorized to settle the costs; or
- obtaining the settlement results from the other contracting officers after initially coordinating with them.

For example, in DCAA Audit Report Numbers 6161-2008G10100001 and 6161-2009G10100002, the DCAA questioned \$9.9 million in direct costs. The DCMA DACO who received the audit reports coordinated with the other contracting officers settling \$7.1 million in questioned direct costs. However, for the remaining \$2.8 million, the DCMA DACO stated that she was unable to identify some of the contracting officers responsible for settling the questioned direct costs. The DACO closed the CAFU system record instead of elevating her issue with identifying the responsible contracting officers to DCMA management, which resulted in a noncompliance with DoD Instruction 7640.02 and DCMA Manual 2201-03.

In another example, in DCAA Audit Report Numbers 2631-2010D10100001 and 2631-2011D10100001, the DCAA questioned \$24.3 million in direct costs. The DCMA DACO who received the audit reports coordinated with the other contracting officers who were responsible for settling \$24.3 million in questioned direct costs. Although the DCMA DACO received the settlement results for \$3.7 million of the \$24.3 million, she did not obtain the settlement results for the remaining \$20.6 million. The DCMA DACO stated that she made repeated requests to obtain the settlement results for the remaining \$20.6 million in questioned direct costs. However, the DCMA DACO ultimately closed the CAFU record without receiving the settlement results. The DCMA DACO stated that she closed the CAFU system records due to her concern that the 6-year statute of limitations was going to expire soon.¹⁷ However, the DCMA DACO did not consult with DCMA legal counsel over her concern with the 6-year statute of limitations prior to closing the two audit reports in CAFU system. Closing the CAFU system records without obtaining the responses from the other contracting officers did not comply with DoD Instruction 7640.02 and DCMA Manual 2201-03.

Although DCMA Manual 2201-03 requires the DCMA DACO who receives a DCAA audit report to coordinate with other contracting officers who are responsible for settling the questioned direct costs, it does not provide any guidance on how to identify all responsible DoD contracting officers. Furthermore, DCMA Manual 2201-03 does not provide any guidance for addressing situations when the other DoD contracting officers do not respond to the DCMA contracting officer's repeated requests to provide settlement results of the questioned direct costs.

In April 2020, the DCMA developed a contracting officer locator form that describes specific actions to take when DCMA contracting officers are unable to identify the DoD contracting officers responsible for settling questioned direct

¹⁷ 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.

costs or they experience delays in receiving the settlement results. Use of the locator form should help DCMA DACOs identify the DoD contracting officers responsible for settling the questioned direct costs. The DCMA posted the locator form to its internal website, but the form has not been incorporated into DCMA Manual 2201-03.

DCMA Supervisors and the DCMA OIG Did Not Provide Effective Oversight of DCMA DACO Actions to Settle Questioned Direct Costs

We determined that both the DCMA supervisors and the DCMA OIG did not provide effective oversight of DCMA DACO actions to settle questioned direct costs. Paragraph 3.9 of DCMA Manual 2201-03 requires supervisors to indicate their review and concurrence of the DCMA contracting officer actions with a signature in the negotiation memorandum. In all 12 instances, the supervisors signed the negotiation memorandum even though the DACOs' negotiation memorandums did not document that all questioned direct costs were settled. Supervision is a key control for monitoring contracting officer actions. However, the supervisor signatures in this case did not serve as an effective control for ensuring that DCMA DACOs completed all actions to settle the questioned direct costs on the 12 DCAA audit reports. An effective supervisory review of the DCMA DACOs' negotiation memorandums should have identified that the DCMA DACOs did not obtain a settlement determination on all questioned direct costs and prompted the supervisors to request that the DACOs take the necessary corrective actions.

In April 2020, the DCMA developed a CAFU checklist, an additional internal control to help ensure that DCMA contracting officers appropriately settle DCAA audit reports. The supervisors' use of the CAFU checklist should help them ensure the DCMA contracting officers have completed all actions necessary to settle the questioned direct costs before closing the record in the CAFU system. The DCMA posted the CAFU checklist to its internal website, but the form has not been incorporated into DCMA Manual 2201-03.

In addition, DoD Instruction 7640.02 requires the DCMA to perform periodic internal reviews of DCMA contracting officer actions on DCAA audit reports to determine whether they took timely and effective action on audit findings and recommendations.¹⁸ DCMA OIG officials stated that the DCMA OIG periodically evaluates compliance with DoD Instruction 7640.02 and DCMA policy, but only of a DCMA ACO, and only when the DCMA ACO is the primary recipient of a DCAA audit report. The DCMA OIG does not evaluate the actions that a DCMA DACO

¹⁸ DoD Instruction 7640.02, Enclosure 2, Section 3.g, "Policy for Follow-Up on Contract Audit Reports," April 15, 2015.

took on any DCAA audit reports, including those that questioned direct costs. The DCAA issued 25 of the 26 reports selected for this review to a DCMA DACO for action and the DCMA DACO had the responsibility to coordinate the settlement of the questioned direct costs and correctly update the status of the CAFU system records. Therefore, none of the 25 reports were subject to a DCMA OIG review because a DCMA ACO was not the primary recipient of the 25 reports.

Effective DCMA OIG monitoring of DCMA DACO actions could have identified the lack of actions on the questioned direct costs and prompted the DCMA OIG to request that the DACOs take corrective actions. Timely settlement of all audit findings and recommendations, including questioned direct costs, is critical for ensuring that contractors are not inadvertently reimbursed for unallowable costs.

DCMA Manual 2201-03 States That DCMA ACOs Must Settle Questioned Direct Costs

DCMA Manual 2201-03 states that DCMA ACOs (which does not include DCMA DACOs) must settle questioned direct costs. DCMA Manual 2201-03 does not indicate whether or not DCMA DACOs have the authority to settle questioned direct costs. We spoke to several DCMA DACOs who stated that, based on their interpretation of DCMA Manual 2201-03, the DCMA has not granted them the authority to settle questioned direct costs. DCMA DACOs not settling questioned direct costs causes delays because the DCMA DACOs often must coordinate with, and receive settlements from, several different DCMA ACOs and other contracting officers who are specifically authorized by the DCMA Manual 2201-01 to settle questioned direct costs.

DCMA Manual 2201-03 does not authorize DCMA DACOs to settle questioned direct costs based on the DCMA's interpretation of FAR 42.302(a)(9). FAR 42.302(a)(9) states that the contracts administration office (typically the DCMA) is responsible for establishing final indirect cost rates; however, the FAR does not specifically identify who is responsible for settling direct costs. The DCMA typically tasks DCMA DACOs with the responsibility for establishing indirect cost rates in accordance with FAR 42.302(a)(9). However, because the FAR lacks specificity for establishing responsibility over direct costs, DCMA Manual 2201-03, section 3.11, implements policy that only allows the DCMA ACOs assigned to each contract to settle questioned direct costs. When the DCAA questions a contractor's direct costs, the questioned costs can involve dozens of contracts and several different DCMA ACOs. Additionally, questioned direct costs can involve contracting officers from the DoD and other Government agencies.

We spoke to representatives from the DPC, which is responsible for acquisition policy for the DoD. The representatives stated that FAR 42.302(a)(9) does not prohibit DCMA DACOs from having the authority to settle direct costs.

The representatives explained that direct costs are an integral part of an indirect cost rate because the direct costs are used as the base (denominator) to calculate the indirect cost rate.¹⁹ Therefore, the representatives stated that when a DCMA DACO settles indirect cost rates, the DACO should give due consideration to the DCAA questioned direct costs.

DCMA Contracting Officers May Have Reimbursed DoD Contractors Up To \$231.5 Million in Unallowable Direct Costs

In 12 of 26 DCAA audit reports we reviewed, the DCMA contracting officers did not settle \$231.5 million of the \$258 million in reported DCAA questioned direct costs. As described in Table 2, the DCMA contracting officers settled the remaining \$26.5 million in reported DCAA questioned direct costs. The DCMA DACOs received the 12 audit reports for settlement between February 2006 and September 2017. Although DoD Instruction 7640.02 and DCMA Manual 2201-03 require DCMA contracting officers to settle a DCAA audit report within 12 months, the DCMA contracting officers still have not settled, or fully coordinated the settlement of, the questioned direct costs within the 12 audit reports as of August 1, 2020 (56 months ago, on average, as of August 1, 2020). As a result, DCMA contracting officers' actions may have resulted in DoD contractors being reimbursed up to \$231.5 million in questioned direct costs that may not be allowable on Government contracts.

Timely settlement of questioned direct costs is critical for recouping any unallowable costs and protecting the Government's interests. As time passes without any action, the Government risks the expiration of the 6-year statute of limitation for recovering unallowable costs that the contractor has charged on Government contracts. In addition, the negotiation of unsettled questioned direct costs becomes more difficult over time due to the potential loss of records and the departure of Government personnel with firsthand knowledge of the issues. Finally, when the DCMA contracting officers close the record in the CAFU system without the settlement of all questioned direct costs, the accuracy and reliability of the CAFU system for tracking the status of contracting officer actions on DCAA audit reports is diminished.

¹⁹ The indirect cost rate is the mathematical percentage resulting from dividing the indirect cost by the direct cost (also referred to as the "base").

Defense Contract Management Agency Comments on the Finding

The DCMA Director agreed that the current version of DCMA Manual 2201-03 does not adequately clarify the different contracting officer roles and authority in settling DCAA questioned direct costs. However, the DCMA Director maintained that DCMA contracting officers only have the authority to settle DCAA questioned direct costs when delegated the authority by a DoD Component contracting officer.

In addition, the DCMA Director does not interpret FAR 42.302(a)(9) as conferring DCMA contracting officers the authority to settle or negotiate DCAA direct costs. The DCMA Director stated that the FAR grants DCMA ACOs and DACOs only the authority to establish final indirect cost rates and billing rates. The DCMA Director further stated that the FAR does not extend questioned direct costs settlement authority to DCMA contracting officers because DoD Component contracting officers are better suited to settle DCAA questioned direct costs because they negotiate the contract terms with the contractor, award the contract, and understand the expectations of the parties. Finally, the DCMA Director stated that this report unfairly implies that DCMA ACOs are responsible for the failure to settle direct costs questioned by the DCAA.

Our Response

We disagree with the DCMA's position that the FAR prohibits DCMA ACOs and DACOs from settling DCAA questioned direct costs. FAR 1.102-4(e) states:

...If a policy or procedure, or a particular strategy or practice, is in the best interest of the Government and is not specifically addressed in the FAR, nor prohibited by law (statute or case law), Executive order or other regulation, Government members of the Team should not assume it is prohibited. Rather, absence of direction should be interpreted as permitting the Team to innovate and use sound business judgment that is otherwise consistent with law and within the limits of their authority. Contracting officers should take the lead in encouraging business process innovations and ensuring that business decisions are sound.²⁰

The FAR does not prohibit DCMA ACOs and DACOs from settling DCAA questioned direct costs. The DPC, which establishes DoD acquisition policy, stated that DCMA DACOs do have the authority to settle questioned direct costs as part of their administrative responsibilities in establishing indirect rates in accordance with FAR 42.302(a)(9). Furthermore, according to representatives from the

²⁰ FAR 1.102-4, "Role of the Acquisition Team."

DoD Components, DCMA contracting officer have the authority to settle DCAA questioned direct costs because the DCMA is identified as the contracts administration office on most contracts.

As previously stated, FAR 42.302(a)(9) grants both DCMA ACOs and DACOs the authority to settle questioned direct costs.²¹ Even if the FAR does not grant such authority, the DCMA ACOs or DACOs were still responsible for determining who had authority and coordinating with them to ensure the questioned costs were settled before closing the CAFU record. However, the DCMA ACOs and DACOs did not comply with the FAR, DoD Instruction 7640.02, and DCMA Manual 2201-03, when they closed CAFU system records for 12 of the 26 audit reports before they settled the questioned direct costs.

Recommendations, Management Comments, and Our Response

Recommendation A.1

We recommend that the Defense Contract Management Agency Director require the Defense Contract Management Agency divisional contracting officers to:

- a. **Reopen the 12 Defense Contract Audit Agency audit reports shown in Tables 1 and 2 in the Contract Audit Follow-Up System because the questioned direct costs have not been settled.**
- b. **Coordinate the settlement of the questioned direct costs with the contracting officers with settlement responsibility.**
- c. **Consult with legal counsel for any concerns that the 6-year statute of limitations has expired or may expire soon.**
- d. **Explore available remedies for recovering any unallowable direct costs that were reimbursed to the contractor on DoD contracts.**
- e. **Close the 12 records shown in Tables 1 and 2 in the Contract Audit Follow-up System after all questioned direct costs are settled.**

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation, stating that the DCMA would complete the required actions by October 1, 2022, with the exception of those CAFU records that are under litigation or criminal investigation.

²¹ There maybe an exception where a DoD Component contracting officer delegates contract administration to the DCMA on a majority of contracts, but withholds delegation of contract administration to the DCMA on a specific contract.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation once we verify that the DCMA DACOs completed all actions required to settle questioned direct costs.

Recommendation A.2

We recommend that the Defense Contract Management Agency Director:

- a. Review the contracting officers' actions for closing the 12 reports from Tables 1 and 2 in the Contract Audit Follow-up system without settling all questioned direct costs in noncompliance with DoD Instruction 7640.02; and**
- b. Based on the results of the review, take action as appropriate for the noncompliances, such as providing remedial training or initiating management action to hold personnel accountable.**

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation, stating that the DCMA would complete the required actions by May 1, 2022. The DCMA Director stated that the DCMA reviewed the DCMA DACOs' actions and determined that the records will be reopened in an attempt to settle questioned direct costs. Additionally, the DCMA created ad hoc training on coordinating the settlement of questioned direct costs and will update existing training to incorporate instructions for settling questioned direct costs. The DCMA DACOs identified in this report will receive the ad hoc or updated training.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation once we verify that the DCMA DACOs assigned to the 12 audit reports have received the ad hoc training and the DCMA has updated its existing training.

Recommendation A.3

We recommend that the Defense Contract Management Agency Director require the supervisors of the Defense Contract Management Agency divisional administrative contracting officers responsible for the 12 Defense Contract Audit Agency audit reports shown in Tables 1 and 2 to take the training on the requirements for settling questioned direct costs outlined in DoD Instruction 7640.02, "Policy for Follow-up of Contract Audit Reports;" Defense Contract Management Agency Manual 2201-03, "Final Indirect Cost Rates;" and Manual 2201-04, "Contract Audit Follow-Up."

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that ad hoc training for supervisors on the settlement of questioned direct costs has been created for supervisors and will be provided by May 1, 2021.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation once we verify that the DCMA supervisors of the DCMA DACOs assigned to the 12 audit reports have received the ad hoc training on settlement of questioned direct costs.

Recommendation A.4

We recommend that the Defense Contract Management Agency Director update Defense Contract Management Agency Manual 2201-03, "Final Indirect Cost Rates," and Manual 2201-04, "Contract Audit Follow-Up," to require that:

- a. Contracting officers use the contracting officer locator form to identify contracting officers responsible for settling questioned direct costs.
- b. Contracting officers and supervisors use the Contract Audit Follow-Up checklist to help ensure that the findings and recommendations related to questioned direct costs have been settled before the record is closed in the Contract Audit Follow-Up system.

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation, stating that the DCMA would complete the actions by May 1, 2021. The DCMA Director stated that all DCMA contracting officers will be required to use the CAFU checklist and the contracting officer locator form. The DCMA Manuals 2201-03 and 2201-04 are being revised, in part to require that DCMA contracting officers use the CAFU checklist and the contracting officer locator form.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify DCMA Manuals 2201-03 and 2201-04 have been revised to require that DCMA contracting officers use the CAFU checklist and the contracting officer locator form.

Recommendation A.5

We recommend that the Defense Contract Management Agency Director require that the Defense Contract Management Agency Office of Inspector General perform internal reviews of divisional administrative contracting officer actions on questioned direct costs for compliance with DoD Instruction 7640.02, “Policy for Follow-up of Contract Audit Reports,” and Defense Contract Management Agency Manual 2201-03, “Final Indirect Cost Rates,” and Manual 2201-04, “Contract Audit Follow-Up.”

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that the DCMA OIG added the DCMA Cost and Pricing Regional Command (including audit reports issued to DCMA DACOs) to the FY 2021 schedule for a targeted review to validate compliance with DCMA Manuals 2201-03 and 2201-04.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA OIG performed reviews to validate DCMA DACO compliance with DCMA Manuals 2201-03 and 2201-04.

Recommendation A.6

We recommend that the Defense Contract Management Agency Director conduct a review of the Agency’s policy on settling questioned direct costs to clarify the authority of divisional administrative contracting officers to settle questioned direct costs in Defense Contract Audit Agency audit reports.

Defense Contract Management Agency Comments

The DCMA Director agreed with the recommendation and stated that the DCMA will issue a memorandum to DCMA contracting officers, which clarifies the process for settling questioned direct costs. The DCMA will also work with the DPC to help clarify who has the authority to settle questioned direct costs. In addition, in response to Recommendation A.4, the DCMA will revise DCMA Manuals 2201-03

and 2201-04 to clarify the roles of the DoD contracting officers in settling questioned direct costs, consistent with guidance provided by the DPC. The estimated date for completing these actions is May 1, 2021.

Our Response

Comments from the Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once we verify that the DCMA has revised DCMA Manuals 2201-03 and 2201-04 to clarify on the roles of DoD contracting officers in settling DCAA questioned direct costs that is consistent with guidance issued by the DPC.

Recommendation A.7

We recommend that the Defense Pricing and Contracting Principal Director issue guidance to the DoD Components to clarify who has the authority to settle Defense Contract Audit Agency questioned direct costs in accordance with Federal Acquisition Regulation Subpart 42.3, “Contract Administration Office Functions.”

Defense Pricing and Contracting Comments

The DPC Principal Director stated that he partially agreed with the recommendation to issue guidance to the DoD Components that clarifies who has the authority to settle direct questioned costs. Specifically, the DPC Principal Director will, in coordination with the DCMA, consider the issuance of clarifying guidance if he determines that it will be useful to do so. In addition, the DPC Principal Director will consider a revision to the DFARS to clarify DoD contracting officer roles and their authority in settling questioned direct costs.

Defense Contract Management Agency Comments

While not required to comment on this recommendation, the DCMA Director agreed that clarifying guidance would be useful. The DCMA will work with the DPC in considering whether a DFARS revision is needed to provide clarification on the DoD contracting officer roles and authority regarding settlement of DCAA questioned direct costs.

Our Response

Comments from the DPC Principal Director addressed the specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close the recommendation once the DPC distributes guidance regarding the authority of DoD contracting officers for settling direct costs or issues a DFARS revision.

Finding B

DCMA DACOs Have Not Taken All Actions Required to Settle the Questioned Direct Costs From Three of Eight Audit Reports, as a Previous DoD Office of Inspector General Report Recommended

The DCMA DACOs have not taken all actions required to settle the questioned direct costs from three of the eight DCAA audit reports, as DoD OIG Report No. DODIG-2017-055 recommended more than 3 years ago, in February 2017.²² The DCMA DACOs continue to be in noncompliance with DoD Instruction 7640.02 and DCMA Manuals 2201-03 and 2201-04 because \$98.1 million of the \$304.8 million questioned direct costs still needs to be settled. In DoD OIG Report No. DODIG-2017-055, we recommended that the DCMA Director require the DCMA contracting officers to:

- settle, or coordinate the settlement of, \$304.8 million in questioned direct costs that the DCAA reported on in the eight audit reports; and
- correct the inaccurate CAFU system data for four of the eight DCAA audit reports.

In addition, two of the three DCMA DACOs assigned to the three reports closed the associated records in the CAFU system even though they have not completed all of the actions required to settle the questioned direct costs. For the remaining five reports, DCMA contracting officers settled, or coordinated the settlement of, the questioned direct costs and closed the CAFU system records when they completed all required actions.

The DCMA DACOs stated that they have not taken all of the actions required to settle the questioned direct costs for the three audit reports in part because they experienced difficulties determining the other DoD contracting officers who were responsible for settling portions of the questioned direct costs. Nevertheless, the DCMA DACOs were still responsible for identifying who has responsibility to settle the questioned direct costs and to keep the record open in the CAFU system until all questioned direct costs are settled.

²² In Report DODIG-2017-055, "Evaluation of Defense Contract Management Agency Contracting Officer Actions on Defense Contract Audit Agency Incurred Cost Audit Report," February 9, 2017, we identified that contracting officers did not settle questioned direct costs in eight DCAA incurred cost audit reports although the contracting officers closed the audit reports in the CAFU system.

As a result, DCMA DACOs may have reimbursed DoD contractors up to \$98.1 million in costs that may not be allowable on Government contracts in accordance with FAR subpart 31.2. Appropriately addressing questioned direct costs in a timely manner by DCMA contracting officers is important for ensuring that the Government does not reimburse DoD contractors for costs that are unallowable.

The DCMA Has Not Taken All Actions Required to Settle \$98.1 Million in Questioned Direct Costs From Three of the Eight Audit Reports, as a DoD Office of Inspector General Report Recommended

The DCMA has not taken all actions required to settle \$98.1 million in DCAA questioned direct costs from three of the eight DCAA audit reports identified in DoD OIG Report No. DODIG-2017-055. In DoD OIG Report No. DODIG-2017-055, we recommended that the DCMA Director require the DCMA contracting officers to:

- settle, or coordinate the settlement of, DCAA questioned direct costs totaling \$304.8 million in eight audit reports (Recommendations A.1, A.2, and D.1); and
- correct the inaccurate CAFU system data on four DCAA audit reports (Recommendation E.1).

In response to the DoD OIG report, the DCMA agreed to settle or coordinate the settlement of the questioned direct cost for all eight reports and to correct the inaccurate CAFU system data.

However, the DCMA DACOs assigned to three of the eight reports have not settled \$98.1 million of \$131.6 million in questioned direct costs even though the DCAA audit reports were issued to the DCMA for action more than 6 years ago. For the remaining five DCAA audit reports, the DCMA contracting officers completed the actions required for settling \$173.2 million in questioned direct costs reported by the DCAA, as Report No. DODIG-2017-055 recommended. Table 3 shows the status of the actions on the questioned direct costs in all eight DCAA audit reports.

Table 3. Questioned Direct Costs Unsettled and Settled From Report No. DODIG-2017-055

	DCAA Audit Report Number	DCAA Questioned Direct Costs	Settled Questioned Direct Costs	Unsettled Questioned Direct Costs
1	6271-2003A10100103	\$98,167,148	\$24,507,628	\$73,659,520
2	6281-2005G10100001	30,440,065	9,057,045	21,383,020
3	2161-2007T10100001	3,052,934	0	3,052,934
	Subtotal - Unsettled Questioned Direct Cost	\$131,660,147	\$33,564,673	\$98,095,474
4	4531-2007K10100001	\$2,385,825	\$2,385,825	\$0
5	1311-2006C10100006	2,900,992	2,900,992	0
6	3181-2009D10100001	4,163,301	4,163,301	0
7	3321-2009K10100002	158,812,697	158,812,697	0
8	3161-2007F10100001	4,922,064	4,922,064	0
	Subtotal - Settled Questioned Direct Cost	\$173,184,879	\$173,184,879	\$0
	Total	\$304,845,026	\$206,749,552	\$98,095,474

Source: DoD OIG based on DCAA and DCMA data.

DCMA DACOs Have Not Taken Action on the \$98.1 Million of \$131.6 Million in Questioned Direct Costs

For three DCAA audit reports, we determined that DCMA DACOs have not taken all actions required to settle \$98.1 million of \$131.6 million in questioned direct costs even though the DCAA audit reports were issued to the DCMA for action more than 6 years ago. Report No. DODIG-2017-055, recommended more than 3 years ago that the DCMA contracting officers complete the actions required to settle, or coordinate the settlement of, the questioned direct costs. DCMA DACOs were responsible for taking action on the questioned direct costs within 12 months of receiving the DCAA audit report and accurately recording the status of their actions in the CAFU system, in accordance with DoD Instruction 7640.02 and DCMA Manual 2201-04.

For example, the DCMA DACO who received DCAA Audit Report No. 6271-2003A10100103 was responsible for coordinating with DCMA ACOs for the settlement of \$24.5 million of the \$98.2 million in questioned direct costs. The DCMA ACOs settled the \$24.5 million, but the DCMA DACO did not coordinate with the other DoD contracting officers who were responsible for settling the remaining \$73.7 million. The DCMA DACO closed the record in the CAFU system without documenting any comments on the status of the \$73.7 million questioned direct costs.

The DCMA DACO did not comply with DoD Instruction 7640.02 and DCMA Manuals 2201-03 and 2201-04 when she closed the record in the CAFU before the \$73.7 million in questioned direct costs were settled. The DCMA DACO left the agency and the newly assigned DCMA DACO stated that the former DCMA DACO experienced difficulties and delays in identifying and receiving settlement determinations from the DoD contracting officers who were responsible for settling the \$73.7 million in questioned direct costs. Regardless, in accordance with DCMA Manual 2201-03, the DCMA DACO was required to identify the contracting officers responsible for settling the \$73.7 million and keep the CAFU record open until the costs were settled. The DCMA DACO should have immediately elevated to DCMA management any difficulties experienced or delays with identifying the appropriate contracting officers with questioned direct costs settlement responsibility. DCMA management could have assisted the DCMA DACO in identifying DoD contracting officers with settlement responsibility and requesting action from those that had been identified.

For the remaining two audit reports, the DCMA DACOs similarly did not take action to settle \$24.4 million in questioned direct costs. Therefore, we concluded that the DCMA DACOs did not fully address the recommendations in DoD OIG Report No. DODIG-2017-055 and the recommendations remain open.

DCMA Contracting Officers Completed Actions Required to Settle the Questioned Direct Costs in the Five Remaining Audit Reports

For the remaining five DCAA audit reports listed in Table 3, DCMA contracting officers completed the actions required to settle \$173.2 million in questioned direct costs. For example, the DCMA contracting officer for DCAA Audit Report No. 3321-2009K10100002 settled part of the questioned direct costs related to subcontracts, legal services, and legal settlements based on coordination with the DCAA and additional support provided by the contractor during negotiations to demonstrate that the costs were allowable. In addition, the DCMA contracting officer coordinated with several DoD contracting officers to settle the remaining questioned direct costs. See Appendix D for a list of the eight DCAA audit reports and whether DCMA contracting officer actions satisfied the recommendations in DoD OIG Report No. DODIG-2017-055.

DCMA DACOs Have Not Completed Actions Required to Settle \$98.1 Million Because of Difficulties With Identifying Who Had Responsibility to Settle the Questioned Direct Costs

For three of the eight DCAA audit reports, DCMA DACOs stated that they experienced difficulties identifying who had the responsibility to settle the questioned direct costs. As a result, the DCMA DACOs did not complete all actions required to settle the questioned direct costs. For example, one DCMA DACO stated that she attempted to locate the responsible contracting officers at other Government agencies, but those attempts were unsuccessful. In accordance with DCMA Manual 2201-03, the DCMA DACO had an obligation to identify the contracting officers responsible for settling the \$98.1 million and keeping the CAFU record open until the costs were settled. The DCMA DACOs should have elevated the difficulties to DCMA management to resolve the difficulties and successfully settle all of the questioned costs. Use of the newly created contracting officer locator form identified in Finding A and Recommendation A.4 should help the DCMA DACOs identify contracting officers responsible for settling the questioned direct costs.

DCMA Contracting Officers May Have Reimbursed up to \$98.1 Million in Unallowable Costs on Government Contracts

As a result of the DCMA contracting officers not coordinating the settlement of the questioned direct costs, the Government may have reimbursed DoD contractors up to \$98.1 million in costs that may not be allowable on Government contracts. The DCMA DACOs received the three audit reports for settlement between December 2013 and June 2014. Although DoD Instruction 7640.02 and DCMA Manual 2201-03 requires contracting officers to settle a DCAA audit report within 12 months, the DCMA contracting officers still have not settled, or coordinated the settlement of, the questioned direct costs within the three audit reports. The DCMA contracting officers received the reports from DCAA for action 6 years ago on average, as of August 1, 2020. The excessive delays may have jeopardized the ability of the Government to recoup questioned direct costs that may be unallowable because the 6-year statute of limitation for recouping unallowable costs from the contractor may have passed.²³

²³ 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.

In addition, when the DCMA DACOs prematurely closed the records for the reports in the CAFU system, they impacted the accuracy and reliability of the CAFU system, which DoD Component management and the DoD OIG use to track and monitor contracting officer actions on DCAA audit reports.

The Recommendations in Report No. DODIG-2017-055 Remain Open

The Contract Disputes Act's 6-year statute of limitations does not preclude the contracting officer from attempting to settle the questioned direct costs. Recommendations A.1, A.2, and D.1 in DoD OIG Report No. DODIG-2017-055 remain open because the DCMA contracting officers assigned to three of the eight audit reports have not yet settled, or coordinated the settlement of, \$98.1 million of the \$304.8 million in questioned direct costs reported by DCAA in the eight audit reports. We will close the recommendations once we have verified that all questioned direct costs have been settled and the records are closed in the CAFU system. We have not identified any additional recommendations for this finding.

Appendix A

Scope and Methodology

We conducted this evaluation from April 2019 through August 2020 in accordance with the “Quality Standards for Inspection and Evaluations,” published in January 2012 by the Council of Inspector General on Integrity and Efficiency. Those standards require that we plan and perform the evaluation to ensure that objectives are met and that we perform the evaluation to obtain sufficient, competent, and relevant evidence to support the findings, conclusions, and recommendations. We believe that the evidence obtained was sufficient, competent, and relevant to lead a reasonable person to sustain the findings, conclusions, and recommendations.

DCAA Audit Reports Sample

To accomplish our evaluation objective, we evaluated DoD contracting officer actions on 26 DCAA incurred cost audit reports from a universe of 68 DCAA audit reports. The DCAA issued the 26 DCAA audit reports for settlement between February 2006 and September 2017, reporting a total of \$597.4 million in questioned direct costs. Our selection of a sample of 26 DCAA incurred cost audit reports was based on a non-statistical selection of all DCAA audit reports that included at least \$1 million in questioned direct costs and were closed by DoD contracting officers in the CAFU system between October 2017 and September 2018.

For 25 of the 26 DCAA audit reports we selected, DCMA DACOs were responsible for coordinating the settlement of the questioned direct costs and closing the CAFU system record. For the remaining DCAA audit report we selected, a Navy contracting officer was responsible for settling the questioned direct costs and closing the CAFU system record after he completed all required contractual actions.

In addition, we evaluated DCMA contracting officer actions taken in response to Recommendations A.1, A.2, D.1, and E.1 from DoD OIG Report No. DODIG-2017-055. The recommendations stated that the DCMA should take immediate action to settle \$304.8 million in questioned direct costs reported by the DCAA in eight audit reports.

Review of Documentation and Interviews

For the 26 DCAA audit reports we selected for review, we:

- gained an understanding of the 26 DCAA audit reports and associated supporting DCAA audit working papers;
- obtained and evaluated the adequacy of established agency policies available to the contracting officers for addressing the questioned direct costs;
- interviewed DCAA auditors who conducted the audits, as needed;
- interviewed contracting officers and other appropriate personnel involved in taking action on the questioned direct costs;
- obtained and evaluated contracting officer negotiation memorandums and any other records that documented the actions taken by the contracting officers on the DCAA questioned direct costs; and
- evaluated contracting officer actions taken on the questioned direct costs for compliance with the FAR, DoD Instruction 7640.02, and agency policies and procedures.

We conducted site visits at the following DCMA field offices.

- DCMA Sacramento, Roseville, California
- DCMA Hartford, East Hartford, Connecticut
- DCMA Lockheed Martin, Orlando, Florida
- DCMA Manassas, Chantilly, Virginia
- DCMA British Aerospace and Electronics, Sterling, Virginia

Criteria

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

Laws and Regulations

- FAR Part 31, "Contract Cost Principles and Procedures," January 13, 2017
- FAR Part 42, "Contract Administration and Audit Services," November 6, 2017

DoD Directives, Instructions, Manuals, and Policy Memorandums

- DoD Instruction 7640.02, "Policy for Follow-Up on Contract Audit Reports," April 15, 2015

DCMA and DCAA Instructions, Guidance, and Manuals

- DCMA Manual 2201-03, “Final Indirect Cost Rates,” February 14, 2019
- DCMA Manual 2201-04, “Contract Audit Follow-up,” March 3, 2019
- DCMA Instruction 125, “Final Overhead Rates,” April 21, 2014 (replaced by DCMA Manual 2201-03, as of February 14, 2019)
- DCMA Instruction 126, “Contract Audit Follow Up,” February 11, 2016 (replaced by DCMA Manual 2201-04, as of March 3, 2019)
- DCMA Guidance 13-192, “Administrative Contracting Officer Settlement of Questioned Direct Costs Reported by DCAA,” June 21, 2013
- DCAA Contract Audit Manual, January 2014

Use of Computer-Processed Data

In selecting our sample of 26 DCAA audit reports, we obtained a computerized list of audit reports that contracting officers closed in the CAFU system between October 2017 and September 2018. The list of audit reports was generated from the CAFU system. We tested the reliability of the list by tracing the 26 selected reports to source documents and we determined that the data in the list were reliable.

Use of Technical Assistance

We did not rely on technical assistance for this evaluation.

Prior Coverage

DoD OIG

During the last 5 years, the DoD OIG issued three reports that addressed DoD contracting officer actions on DCAA questioned direct costs. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/reports.html/>.

Report No. DODIG-2020-036, “Report on Evaluation of Contracting Officer Actions on Defense Contract Audit Agency Reports that Disclaim an Opinion,” November 26, 2019

The DoD OIG evaluated whether the actions taken by DoD contracting officers on DCAA audit reports that disclaimed an audit opinion complied with the FAR, DoD Instructions, and agency policy. For 2 of 21 audit reports selected for evaluation, the contracting officers did not justify their actions to disagree with the DCAA questioned costs totaling \$219 million.

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

The DoD OIG evaluated and substantiated 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 questioned indirect costs. The same contracting officer did not take appropriate action on an additional \$9 million in questioned direct costs.

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

The DoD OIG evaluated the appropriateness of DCMA actions on DCAA findings reported in 22 incurred cost audit reports. For eight audit reports, the contracting officers did not taken any action on \$304.8 million in DCAA questioned direct costs. In noncompliance with DoD Instruction 7640.02, the contracting officers also closed the CAFU system records before they took any action on the questioned direct costs.

Appendix B

For the 26 audit reports, this appendix identifies the DoD Component responsible for coordinating the settlement of the questioned direct costs and for reporting the correct status of its actions in the CAFU system. The appendix also identifies the DoD Components primarily responsible for settling the questioned direct costs.

Table 4. DoD Components Responsible for Coordinating the Settlement of the Questioned Direct Costs and for Settling the Questioned Direct Costs

	DCAA Report Number	Total Questioned Direct Costs	Contracting Officer Responsible for Coordinating Settlement of Questioned Direct Costs	DoD Component Primarily Responsible for Settling the Questioned Direct Costs (See Table Note)
1	9841-2009C10100001	\$88,502,086	DCMA DACO	DCMA ACOs
2	9841-2010C10100001	104,629,898	DCMA DACO	DCMA ACOs
3	2631-2010D10100001	13,586,159	DCMA DACO	DCMA ACOs, Air Force
4	2631-2011D10100001	10,777,531	DCMA DACO	DCMA ACOs, Air Force
5	3211-2010D10100001S1	1,080,679	DCMA DACO	DCMA ACOs, Air Force
6	4371-2007M10100010	1,731,929	DCMA DACO	DCMA ACOs
7	4371-2008M10100010	3,247,171	DCMA DACO	DCMA ACOs
8	4371-2009M10100018	13,656,359	DCMA DACO	DCMA ACOs
9	4371-2010C10100001	4,642,909	DCMA DACO	DCMA ACOs
10	6161-2008G10100001	5,291,950	DCMA DACO	DCMA ACOs, Army
11	6161-2009G10100002	4,619,491	DCMA DACO	DCMA ACOs, Army
12	6741-2009Q10100001	6,303,155	DCMA DACO	DCMA ACOs, Army
	Subtotal	\$258,069,317		
13	1551-2011A10100003	6,850,732	DCMA DACO	DCMA ACOs, Navy, Army, Air Force
14	1721-2003B10100001	14,114,346	Navy	Navy
15	3321-2010S10180003	12,202,051	DCMA DACO	DCMA ACOs
16	3631-2012A10100001	6,764,211	DCMA DACO	DCMA ACOs, NASA
17	6281-2010G10100001	3,118,078	DCMA DACO	DCMA ACOs
18	6281-2011G10100001	5,001,535	DCMA DACO	DCMA ACOs
19	6421-2006B10100403S1	8,977,735	DCMA DACO	DCMA ACOs
20	6831-2006M10100001	62,411,516	DCMA DACO	DCMA ACOs
21	6831-2008M10100001	96,904,475	DCMA DACO	DCMA ACOs
22	6831-2009M10100001	71,963,683	DCMA DACO	DCMA ACOs

Table 4. DoD Components Responsible for Coordinating the Settlement of the Questioned Direct Costs and for Settling the Questioned Direct Costs (cont'd)

	DCAA Report Number	Total Questioned Direct Costs	Contracting Officer Responsible for Coordinating Settlement of Questioned Direct Costs	DoD Component Primarily Responsible for Settling the Questioned Direct Costs (See Table Note)
23	6851-2007A10100001	8,929,647	DCMA DACO	DCMA ACOs
24	6861-2007C10100375	25,922,913	DCMA DACO	DCMA ACOs
25	9811-2010F10100015	8,840,366	DCMA DACO	DCMA ACOs
26	9811-2011F10100015	7,398,466	DCMA DACO	DCMA ACOs
	Subtotal	\$339,399,754		
	Total	\$597,469,071		

Source: DoD OIG prepared, based on DCMA and DCAA data and from the findings in this report.

Table Note: This column identifies the DoD Components who had settlement responsibility over a majority of the questioned direct costs that we evaluated. It is not an all-inclusive list of all DoD Components that were responsible for settling the questioned direct costs.

Appendix C

This appendix identifies the number of months elapsed between DCAA audit report issuance date and the contracting officer's settlement of the questioned direct costs. For all 26 reports, the contracting officers settled the questioned direct costs in 47 months, on average, after the receipt of the DCAA audit report, which exceeded the 12 month settlement requirement in DoD Instruction 7640.02.

Table 5. Number of Months Elapsed Between DCAA Audit Report Date and Settlement of the Questioned Indirect and Direct Costs Date

	DCAA Audit Report Number	DCAA Audit Report Date	Questioned Direct Costs Settlement Date	Months Elapsed From Report Issuance to Direct Cost Settlement (See Table Note)
1	9841-2009C10100001	03/10/16	Not Settled	52
2	9841-2010C10100001	03/10/16	Not Settled	52
3	2631-2010D10100001	09/30/16	Not Settled	46
4	2631-2011D10100001	09/30/16	Not Settled	46
5	3211-2010D10100001S1	04/21/17	Not Settled	39
6	4371-2007M10100010	09/03/14	Not Settled	70
7	4371-2008M10100010	09/03/14	Not Settled	70
8	4371-2009M10100018	09/30/15	Not Settled	58
9	4371-2010C10100001	09/30/15	Not Settled	58
10	6161-2008G10100001	05/07/15	Not Settled	62
11	6161-2009G10100002	05/07/15	Not Settled	62
12	6741-2009Q10100001	08/04/15	Not Settled	59
	Subtotal Average Months Elapsed			56
13	1551-2011A10100003	04/07/17	02/07/20	34
14	1721-2003B10100001	02/06/06	03/14/14	97
15	3321-2010S10180003	04/28/11	09/05/18	88
16	3631-2012A10100001	09/29/17	09/18/18	11
17	6281-2010G10100001	09/30/16	05/24/17	7
18	6281-2011G10100001	09/30/16	07/09/18	21
19	6421-2006B10100403S1	09/03/13	05/18/18	56
20	6831-2006M10100001	09/30/13	05/11/18	55
21	6831-2008M10100001	12/30/15	07/03/18	30
22	6831-2009M10100001	12/30/15	07/03/18	30

Table 5. Number of Months Elapsed Between DCAA Audit Report Date and Settlement of the Questioned Indirect and Direct Costs Date (cont'd)

	DCAA Audit Report Number	DCAA Audit Report Date	Questioned Direct Costs Settlement Date	Months Elapsed From Report Issuance to Direct Cost Settlement (See Table Note)
23	6851-2007A10100001	04/11/14	03/22/18	47
24	6861-2007C10100375	10/16/14	05/07/18	42
25	9811-2010F10100015	06/30/17	12/26/17	5
26	9811-2011F10100015	06/30/17	06/22/18	11
	Subtotal Average Months Elapsed			38
	Total Average Months Elapsed			47

Source: DoD OIG prepared, based on DCMA and DCAA data and the findings in this report.

Table Note: As of August 1, 2020, the questioned costs for the first 12 listed audit reports were not settled. For these 12 reports, we used August 1, 2020, as the settlement date for calculating the number of months elapsed between the audit report date and the settlement date.

Appendix D

This appendix identifies Recommendations A.1, A.2, D.1, and E.1 from DoD OIG Report No. DODIG-2017-055, the status of the recommendations, and whether the DCMA contracting officers' actions satisfied the intent of the related recommendations.

Table 6. Status of Recommendations and Actions Taken in Response to DoD OIG Report No. DODIG-2017-055

Recommendation from DODIG-2017-055	Recommendation Status (Unresolved, Resolved-Open, or Resolved-Closed)	Actions Performed	Documentation Needed to Close Recommendation
<p>Rec. A.1.a-b: The DoD OIG recommended that the Defense Contract Management Agency Director request the six Defense Contract Management Agency contracting officers with negotiation authority to:</p> <ul style="list-style-type: none"> 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. <p>DCAA Audit Reports: 3321-2009K10100002, 6281-2005G10100001, 4531-2007K10100001, 3161-2007F10100001, 6271-2003A10100103, and 1311-2006C10100006.</p>	Resolved-Open	<p>The DACOs completed actions to settle the \$203 million in questioned direct costs from DCAA audit reports: 3321-2009K10100002, 4531-2007K10100001, 3161-2007F10100001, and 1311-2006C10100006. No further actions required for these audit reports.</p>	<p>The DACOs need to take action to settle the \$95 million in questioned direct costs from DCAA audit reports 6281-2005G10100001 and 6271-2003A10100103.</p>
<p>Rec. A.2.a-b: The DoD OIG recommended that the Defense Contract Management Agency Director direct the two remaining Defense Contract Management Agency contracting officers to:</p> <ul style="list-style-type: none"> 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. <p>DCAA Audit Reports: 2161-2007T10100001 and 3181-2009D10100001.</p>	Resolved-Open	<p>The DACO completed actions to settle the \$4.2 million in questioned direct costs from DCAA audit report 3181-2009D10100001. No further action required for this audit report.</p>	<p>The DACO needs to take action to settle the \$3 million in questioned direct costs from DCAA audit report 2161-2007T10100001.</p>

Table 6. Status of Recommendations and Actions Taken in Response to DoD OIG Report No. DODIG-2017-055 (cont'd)

Recommendation from DODIG-2017-055	Recommendation Status (Unresolved, Resolved-Open, or Resolved-Closed)	Actions Performed	Documentation Needed to Close Recommendation
<p>Rec. D.1.a-c: The DoD OIG recommended that the Defense Contract Management Agency Director request that the contracting officers assigned to Audit Report Numbers 6281-2005G10100001, 3321-2009K10100002, and 4531-2007K10100001:</p> <ul style="list-style-type: none"> 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. 	Resolved-Open	For 3321-2009K10100002 and 4531-2007K10100001, the contracting officers completed the actions; therefore, no further action is required. The recommendation remains open until all reports are addressed.	The DACO needs to take action to settle the \$21.4 million in questioned direct costs from DCAA audit report 6281-2005G10100001.
<p>Rec. E.1.a-d: The DoD OIG recommended that the Defense Contract Management Agency Director 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:</p> <ul style="list-style-type: none"> a. Audit Report No. 2161-2007T10100001, b. Audit Report No. 3161-2007F10100001, c. Audit Report No. 3181-2009D10100001, and d. Audit Report No. 6271-2003A10100103. 	Resolved-Closed	The DCMA DACOs completed the required action.	N/A

Source: DoD OIG prepared, based on DCMA and DCAA data and the findings in this report.

Management Comments

Defense Contract Management Agency Director



DEFENSE CONTRACT MANAGEMENT AGENCY

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

NOV 19 2020

MEMORANDUM FOR DEPARTMENT OF DEFENSE, INSPECTOR GENERAL

SUBJECT: DCMA Management Comments to DODIG Draft Report, "Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs," October 16, 2020 (Project No. D2019-DAPOCF-0130.000)

The Defense Contract Management Agency's response addressing the subject draft report is attached at TAB A.

The point of contact for this response is [REDACTED]

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

David G. Bassett
LTG, USA
Director

Attachment:
TAB A. DCMA Management Comments

Defense Contract Management Agency Director (cont'd)

General DCMA Response:

While we agree that the current version of DCMA Manual 2201-03 (which is being revised) complicated the issue, the FAR does not provide DCMA contracting officers the authority to negotiate or settle direct costs, unless the Procuring Contracting Officer (PCO) has delegated the authority to the DCMA Administrative Contracting Officer (ACO).

FAR Part § 42.302(a), Contract Administration Functions, identifies the default functions and authorities the procuring contracting agency delegates to a Contract Administration Office (CAO). By identifying DCMA in Box 6 of the SF 26, the "Administered by" section of the contract award document, the procuring agency delegates to DCMA, as the CAO, the authority to perform these standard contract administration functions. The procuring agency may delegate additional functions to DCMA as the CAO (see FAR § 42.202), but the functions identified in FAR § 42.302(a) are the extent of the authority conferred to DCMA by simply listing DCMA in Box 6. Therefore, whether DCMA has the authority to negotiate and settle direct costs questioned as unallowable in DCAA incurred cost audits depends on whether the authority is conferred by FAR § 42.302(a). FAR § 42.302(a)(9) delegates authority to the CAO to "[e]stablish final indirect cost rates and billing rates," but does not confer authority to settle or negotiate direct costs.

FAR 42.302(a)(9) is one of three functions delegated to the "cognizant Federal agency" (CFA) identified by 42.302(a), which is usually (but not always) assigned to DCMA (or another CAO) as the Cognizant Federal Agency Official (CFAO) within DoD. The creation of these three CFA authorities recognize that, in some instances, to avoid duplication of effort and ensure consistency, it makes sense to have a single contracting officer make determinations instead of the multiple PCOs issuing contracts. One such circumstance is determining and settling indirect costs. Rather than having each of the numerous PCOs who have contracted with a particular contractor make their own individual determinations as to which of the contractor's indirect costs are allowable, it makes sense to have a single contracting officer perform this function on behalf of the CFA. Otherwise, numerous PCOs would simultaneously perform the same time-consuming task of evaluating the allowability of the contractor's indirect costs. They might also reach different and inconsistent conclusions.

FAR 42.302 does not extend this authority to settle questioned direct costs because these efficiency considerations do not make sense in the context of direct costs. The PCO negotiated the terms and conditions of the agreement with the contractor, awarded the contract, and understands the expectations of the parties, including the scope of the contractor's performance under the contract. The procuring agency also obligated its funds for the contract deliverables. Whether the agency identified as the CFA retains CFAO responsibility or delegates CFAO responsibility to a DCMA ACO (or a contracting officer at another organization as CAO), the assigned CO serving as the CFAO on behalf of the CFA normally does not have the same level of detailed documentation available to the PCO at the procuring agency within DoD about the costs directly charged to a particular contract.

Defense Contract Management Agency Director (cont'd)

Therefore, while we agree DCMA has the responsibility to coordinate the contract audit follow-up (CAFU) system for the Department and should not close out audits in the CAFU system until audits are fully dispositioned, the PCOs, who also receive a copy of any DCAA audit questioning direct costs, are responsible for negotiating and settling those direct costs. We believe the report unfairly implies that DCMA ACOs are responsible for the failure to settle direct costs questioned by DCAA.

Recommendation A.1

We recommend that the Defense Contract Management Agency Director require the Defense Contract Management Agency divisional contracting officers to:

- a. Reopen the 12 Defense Contract Audit Agency audit reports shown in Tables 1 and 2 in the Contract Audit Follow-Up System because the questioned direct costs have not been settled.
- b. Coordinate the settlement of the questioned direct costs with the contracting officers with settlement responsibility.
- c. Consult with legal counsel for any concerns that the 6-year statute of limitations has expired or may expire soon.
- d. Explore available remedies for recovering any unallowable direct costs that were reimbursed to the contractor on DoD contracts.
- e. Close the 12 records shown in Tables 1 and 2 in the Contract Audit Follow-up System after all questioned direct costs are settled.

DCMA Response: DCMA concurs that initial and additional attempts could have been made to coordinate settlement of questioned direct costs with the PCOs and ACOs before closing the audits. However, the \$231M is significantly higher than the dollars actually at risk. The majority of the \$231M in unsettled questioned direct costs would not have been sustained during negotiations with contractors. Additional documentation provided to support questioned costs and/or further understanding of the costs by the auditor often lead to a significant reduction in the questioned cost amounts prior to negotiations. For example, two of the records cited, 9841-2009C10100001 and 9841-2010C10100001, make up \$193M of the \$231M, or 84 percent. Of the \$193M, DCAA questioned \$191M of subcontractor costs in their entirety because the prime contractor did not receive and/or audit incurred cost proposals for those subcontractors. These costs should have been more appropriately categorized as unresolved versus questioned as the prime contractor did receive product and/or services from the subcontractors. Most of the \$191M proposed subcontract dollars would have been found allowable if additional documentation was available and, therefore, were never actually at risk.

Additionally, the statute of limitations (SOL) has already expired for these 12 CAFU records. DCMA received the DCAA audit reports, for the most part, within a year of the SoL expiration, providing little time for DCMA to coordinate with the PCOs and ACOs responsible for settling the direct costs. Despite this fact, DCMA will:

- a) Reopen 8 of the cited records as 4 of the records are currently open;
- b) The cognizant DACOs of the records will coordinate the attempt to settle questioned direct costs with the PCOs and ACOs cognizant over those questioned direct costs, although the fact that the SOL has run out leaves the Government with minimal negotiating leverage;
- c) Consult with legal counsel regarding the statute of limitations;

Defense Contract Management Agency Director (cont'd)

- d) The cognizant DACOs will instruct the PCOs and ACOs with cognizance over the questioned direct costs to explore available remedies for recovering any unallowable direct costs that were reimbursed to the contractor on DoD contracts not currently open; and
- e) The cognizant DACOs will close the CAFU records once all questioned costs are settled and all other matters resolved.

The estimated date of completion is October 1, 2022, with the exception of those records that are under litigation and/or criminal investigation.

Recommendation A.2

We recommend that the Defense Contract Management Agency Director:

- a. Review the contracting officers' actions for closing the 12 reports from Tables 1 and 2 in the Contract Audit Follow-up system without settling all questioned direct costs, in noncompliance with DoD Instruction 7640.02; and
- b. Based on the results of the review, take action as appropriate for the noncompliances, such as providing remedial training or initiating management action to hold personnel accountable.

DCMA Response: DCMA concurs with the recommendation.

a) A review of the contracting officers' actions has been performed and DCMA determined the records will be reopened and coordination with cognizant contracting officers made in an attempt to settle questioned direct costs.

b) Since work on this report has started, DCMA has taken the additional steps of creating ad hoc training on coordination of settlement of questioned direct costs and has widely socialized the requirement to leave audit records open until all questioned costs, both direct and indirect, have been settled. CMC 232 is currently being updated to include additional instruction on settling questioned direct costs. CMC232 is required for DCMA contracting officers and additional ad hoc training will be provided agency wide. The DACOs indicated in the report will receive additional training on the topic.

DCMA is in the process of revising manuals to include clearer guidance in regards to settlement of questioned direct costs and more defined roles for the DACO. DCMA will engage DPC to initiate a DFARS case to add authority to DFARS 242.302 for DCMA ACOs to negotiate and settle questioned direct costs.

The estimated date of completion is May 1, 2022.

Recommendation A.3

We recommend that the Defense Contract Management Agency Director require the supervisors of the Defense Contract Management Agency divisional administrative contracting officers responsible for the 12 Defense Contract Audit Agency audit reports shown in Tables 1 and 2 to take the training on the requirements for settling questioned direct costs outlined in DoD Instruction 7640.02, "Policy for Follow-up of Contract Audit Reports," Defense Contract Management Agency Manual 2201-03, "Final Indirect Cost Rates," and Manual 2201-04, "Contract Audit Follow-Up."

Defense Contract Management Agency Director (cont'd)

DCMA Response: DCMA concurs with this recommendation. Since work on this report has begun, ad hoc additional training on settlement of questioned direct costs has been created for supervisors and will be provided via lunch and learn training sessions. The Board of Review manual revision will discuss the need to have a board of review when there is a significant delta between DCAA questioned costs and settlement amounts allowing the DCMA contracting officers to dispute the DCAA questioned cost amount as provided in the example on response A.1.

Moreover, as recognized in the report, DCMA developed a CAFU checklist which will become mandatory with the published revision of manual 2201-04. The checklist requires supervisors to concur that all questioned direct costs have been settled. Additionally, DCMA developed a PCO locator and escalation process which are available for use on the CAFU resource page. DCMA will hold additional training for the supervisors of record for the DACOs responsible for the 12 records, if they still work for the agency.

The estimated date of completion is May 1, 2021.

Recommendation A.4

We recommend that the Defense Contract Management Agency Director update Defense Contract Management Agency Manual 2201-03, "Final Indirect Cost Rates," and Manual 2201 04, "Contract Audit Follow-Up," to require that:

- a. Contracting officers use the contracting officer locator form to identify contracting officers responsible for settling questioned direct costs.
- b. Contracting officers and supervisors use the Contract Audit Follow-Up checklist to help ensure that the findings and recommendations related to questioned direct costs have been settled before the record is closed in the CAFU system.

DCMA Response: DCMA concurs with this recommendation and will require all DCMA contracting officers utilize both the CAFU checklist and PCO locator process. The Buying Commands have been provided copies of both for their use; however, DCMA mandatory utilization policy does not extend to them. Both the checklist and locator process are currently available on the Resource page for the CAFU manual and the CAFU checklist will be mandatory when the revised CAFU manual is published. DCMA manual 2201-03 and 2201-04 are currently undergoing revisions and are expected to be released in the near future. As indicated above, the manuals will also more clearly identify the roles of the DCMA DACOs, ACOs, as well as DoD PCOs, in settling questioned direct costs, consistent with any additional guidance provided by DPC in conjunction with the potential DFARS case.

a) DCMA contracting officers can now use the PCO locator form, available on the resource page for manual 2201-04. The Contract Management Team (CMT) e-tool is available for DCMA contracting officers use when searching for cognizant ACOs.

b) The CAFU Checklist will be mandatory with the updated publication of manual 2201-04. The DCMA Cost/Pricing Command has already made the CAFU checklist mandatory for their contracting officers.

Defense Contract Management Agency Director (cont'd)

The estimated date of completion is May 1, 2021.

Recommendation A.5

We recommend that the Defense Contract Management Agency Director require that the Defense Contract Management Agency Office of Inspector General perform internal reviews of divisional administrative contracting officer actions on questioned direct costs for compliance with DoD Instruction 7640.02, "Policy for Follow-up of Contract Audit Reports," and Defense Contract Management Agency Manual 2201-03, "Final Indirect Cost Rates," and Manual 2201-04, "Contract Audit Follow-Up."

DCMA Response: DCMA concurs with this recommendation. The IET has added the Cost and Pricing Regional Command to the FY21 schedule for a targeted process review to validate compliance to Defense Contract Management Agency Manual 2201-03, Final Indirect Cost Rates and Manual 2201-04, Contract Audit Follow-Up with focus on direct and indirect questioned cost.

Recommendation A.6

We recommend that the Defense Contract Management Agency Director conduct a review of the Agency's policy on settling questioned direct costs to clarify the authority of divisional administrative contracting officers to settle questioned direct costs in Defense Contract Audit Agency audit reports.

DCMA Response: DCMA Concurs. As mentioned above in response to Recommendation A.4, DCMA Manuals 2201-03 and 2201-04 are currently undergoing revisions and will clarify the roles of DCMA DACOs and ACOs, as well as DoD PCOs, in settling questioned direct costs, consistent with additional guidance provided by DPC. DCMA will issue an internal memo clarifying the process for settling questioned direct costs and engage with DPC to initiate a DoD wide memo to clarify who has authority to settle questioned direct costs.

The estimated date of completion is May 1, 2021.

Recommendation A.7

We recommend that the Defense Pricing and Contracting Principal Director issue guidance to the DoD Components to clarify who has the authority to settle Defense Contract Audit Agency questioned direct costs in accordance with Federal Acquisition Regulation Subpart 42.3, "Contract Administration Office Functions."

DCMA Response: DPC and DCMA agree that clarifying guidance would be useful. DCMA Manuals 2201-03 and 2201-04 are currently undergoing revisions to clarify the roles of DCMA DACOs and ACOs in settling questioned direct costs. DCMA will engage DPC to initiate a DFARS case to provide clarification of roles and authority regarding settlement of DCAA-questioned direct costs.

Defense Pricing and Contracting Principal Director



ACQUISITION
AND SUSTAINMENT

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

MEMORANDUM FOR AUDIT OVERSIGHT DIRECTOR FOR EVALUATIONS OF
SPACE, INTELLIGENCE, ENGINEERING, AND OVERSIGHT,
OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Response to DoDIG Draft Evaluation of Department of Defense Contracting Officer
Actions on Questioned Direct Costs (Project No. D2019-DAPOCF-0130.000)

As requested, I am providing responses to the general content and recommendations
contained in the subject report. I have identified no specific information in the draft report that is
Controlled Unclassified Information (CUI) and there is no CUI in this response.

Recommendation A.7: We recommend that the Defense Pricing and Contracting Principal
Director issue guidance to the DoD Components to clarify who has the authority to settle
Defense Contract Audit Agency questioned direct costs in accordance with Federal Acquisition
Regulation Subpart 42.3, "Contract Administration Office Functions."

Response: Partially Concur. Defense Pricing and Contracting (DPC) agrees that clarifying
guidance may be useful. Defense Contract Management Agency (DCMA) is revising DCMA
Manuals 2201-03 and 2201-04 to clarify the roles and authority of DCMA Divisional
Administrative Contracting Officers and Administrative Contracting Officers in settling Defense
Contract Audit Agency-questioned direct costs. DPC will, in coordination with DCMA,
consider a revision to the Defense Federal Acquisition Regulation Supplement (DFARS) to
clarify these roles and authority in the regulation. The Defense Acquisition Regulations Council
is responsible for developing revisions to the regulations that are responsive to overall DoD
needs and, through its activities, will assess whether a DFARS revision is feasible in this instance.

My point of contact for this response is [REDACTED],
[REDACTED], if additional information is required.

TENAGLIA
JOHN.M
M [REDACTED]
Date: 2020.11.17
08:23:22 -05'00'

John M. Tenaglia
Principal Director,
Defense Pricing and Contracting

Acronyms and Abbreviations

ACO	Administrative Contracting Officer
CAFU	Contract Audit Follow-up
DACO	Divisional Administrative Contracting Officer
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DPC	Defense Pricing and Contracting
FAR	Federal Acquisition Regulation



Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

Whistleblower Protection safeguards DoD employees against retaliation for protected disclosures that expose possible waste, fraud, and abuse in government programs. For more information, please visit the Whistleblower webpage at <http://www.dodig.mil/Components/Administrative-Investigations/Whistleblower-Reprisal-Investigations/Whistleblower-Reprisal/> or contact the Whistleblower Protection Coordinator at Whistleblowerprotectioncoordinator@dodig.mil

For more information about DoD OIG reports or activities, please contact us:

Congressional Liaison

703.604.8324

Media Contact

public.affairs@dodig.mil; 703.604.8324

DoD OIG Mailing Lists

www.dodig.mil/Mailing-Lists/

Twitter

www.twitter.com/DoD_IG

DoD Hotline

www.dodig.mil/hotline



DEPARTMENT OF DEFENSE | OFFICE OF INSPECTOR GENERAL

4800 Mark Center Drive
Alexandria, Virginia 22350-1500
www.dodig.mil
DoD Hotline 1.800.424.9098

