

Compensation Audits

Written by Nick Sanders
Friday, 12 April 2019 00:00

A reader who wishes to remain anonymous brought to our attention a recent DOD Office of Inspector General [audit report](#) addressing DCMA contracting officer sustention of DCAA audit findings regarding contractor executive compensation. The audit report's findings lead us to suspect that contracting officers are going to be more reluctant to disagree with future DCAA audit findings in that area.

But before we address the DoD OIG audit report's findings in detail, let's discuss audit sustention rates. To be clear, we've discussed the topic before; in fact, a January 2019 [article](#) was devoted exclusively to the topic. In that article we wrote "The CQ sustention rate is a real indicator of audit quality. It tells us the percentage of time that a contracting officer is persuaded by an audit finding. It tells us the percentage of time that a contractor is unsuccessful at persuading a contracting officer that a DCAA audit finding is wrong. It is as close to a definition of 'win' or 'lose' as we have."

We noted in that article that the GFY 2017 audit sustention rate was 29%. The GFY 2018 audit sustention rate was a bit higher—roughly 31% of costs questioned. In either case, though, not stellar. Less than one-third of all DCAA questioned costs are being sustained.

The pressure to increase sustention rates is noticeable. We see it in contracting officer negotiations. And now we are seeing it in DoD OIG audit reports. *The latest OIG audit report blames DCMA contracting officers for failing to sustain DCAA audit findings*—even though those same contracting officers are charged with using independent business judgment to resolve issues before they become litigable disputes.

Let's look at that DoD OIG audit report in light of the context we've (hopefully) established. The OIG found fault with DCMA contracting officers that failed to sustain DCAA findings that contractor executive compensation was unreasonable in 18 of 35 situations reviewed. The 18 contracting officers with whom the OIG auditors disagreed failed to sustain DCAA's audit findings for several reasons, including:

- CO found that DCAA's use of a 10% Range of Reasonableness (RoR) factor was invalid, relying on two ASBCA cases (*J.F. Taylor* and *Metron*).
- CO found that the questioned compensation was reasonable when adjusted for locality pay.
- CO found that the questioned compensation was reasonable when the executives were grouped into one single job class, rather than being evaluated on an individual basis.
- CO found that the questioned compensation was (largely) reasonable when the contractor provided additional information showing that DCAA's audit findings were factually incorrect.

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The OIG audit report criticized the DCMA contracting officers who disagreed with DCAA's findings. Let's focus on one specific area of contention: the use of a 10% RoR to determine the reasonableness of executive compensation.

When a contractor executive's compensation exceeds what a benchmark survey indicates should be the mid-point, DCAA adds 10% to the mid-point before questioning any costs. In other words, DCAA's position is that contractors should never pay their executives more than 10% higher than the survey mid-point for the position, because that would be unreasonable. The DoD OIG audit report treated that approach as if it were a feature instead of a bug, stating "DCAA adds a 10 percent RoR factor to help identify and question only claimed executive compensation that significantly exceeds the survey average. DCAA would actually question a larger amount of compensation as unreasonable if it did not add the RoR factor to the survey average."

DCAA's overly rigid approach was rejected by the ASBCA twice. But the OIG ignored those relatively recent ASBCA cases and, instead, inaptly focused on an older ASBCA case (*Techplan* *n*). In *J. F. Taylor*, the Board found nine separate errors in DCAA's methodology, including—

- Ignored data dispersion/Use of arbitrary 'range of reasonableness' allowance
- Ignored differences in survey sizes
- Inconsistent reliance on surveys
- Inconsistent use of 50% percentile vs. mean

The Board concluded that DCAA's methodology was "fatally flawed statistically and therefore unreasonable."

In *Metron*, the Board rejected nearly every aspect of DCAA's compensation comparison methodology.

But those facts didn't stop the DoD OIG from criticizing the contracting officers' use of those cases to disagree with similar DCAA findings; the OIG audit report stated "The contracting

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officers' interpretation of the Metron and JF Taylor cases is inaccurate." In our view, the DoD OIG's interpretation of those cases, which seemingly relies on a DCAA talking point memo, is inaccurate.

For example, the OIG ignores the August 2012 Board's decision rejecting the government's motion for reconsideration in the J.F. Taylor case. In that motion, the government expressly argued that the decision "was inconsistent with *Techplan* and *ISN*"—an argument that the Board dismissed, writing —

We considered *Techplan* in our decision and found that JFT was challenging step 6 of the *Techplan* analysis. Here we were presented with evidence that DCAA used a 10% ROR regardless of the variability of the data, evidence not presented in *Techplan* and we evaluated the reasonableness of the compensation in light of that evidence. Neither party in *Techplan* or *ISN* offered any statistical analysis of the ROR or raised the same arguments as did JFT and thus the issues were different. It should not be surprising that the outcome could also be different.

Read that paragraph above carefully. The Board expressly rejected DCAA's use of an arbitrary 10% RoR "regardless of the variability of the [benchmark survey] data." Clearly, the Board found that DCAA's rigid approach was *not* in compliance with *Techplan*. The DoD OIG audit report curiously omits this factual finding—a fact that would tend to support the DCMA contracting officers' decisions to non-sustain DCAA's audit findings in this area. Instead, the OIG report recommended that, when contracting officers disagree with DCAA, they should consult with legal counsel to obtain a "legal opinion to ensure that their interpretation of the FAR was accurate."

Now, this is new. According to the DoD OIG, whenever a DCMA contracting officer disagrees with a DCAA audit finding, that contracting officer is now prohibited from using independent business judgment and must, instead, refer the matter to legal counsel. In other words, that warrant isn't worth very much. The basis for the OIG's position seems to be a single sentence within DCMA Instruction 126, which states "If the ACO disagrees with the audit findings and the disagreement is based on an interpretation of a law or regulation, the ACO should consult with the supervisor and Agency legal counsel." We see the word "should" in that sentence, which is

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a far cry from the word “shall,” which would denote the imperative. In other words, “should” is discretionary and the OIG audit report finding is largely based on flipping a discretionary action into a mandatory action—and then criticizing contracting officers for exercising their discretion.

Let’s note that the Director of DCMA agreed with the criticisms and associated recommendations. The DoD OIG audit report stated—

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

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

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

What is a poor CO to do? If they don’t do their jobs, they get criticized. If they do their jobs and follow their Instructions, they get criticized. It’s a wonder any CO stays with DoD.