

Why Won't Contracting Officers Settle Questioned Direct Costs? (Part 2)

Written by Nick Sanders

Wednesday, 03 February 2021 00:00

We were discussing a recent Department of Defense Inspector General audit report that criticized DCMA contracting officers for not settling direct costs questioned by DCAA auditors during their audits of contractor “incurred cost” submissions.

Readers may recall that DoDIG Audit Report No. [DODIG-2021-047](#) (“Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs”) opined that “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.”

When the DoD IG auditors say “DCMA contracting officers,” they are pointing the finger at an amorphous group of contracting officers in a Contract Administration Office (CAO), a group that includes ACOs, DACOs, and perhaps CACOs. We noted in the previous article that the roles and responsibilities for each of those positions is fairly opaque and undefined. About the only thing we know is that “According to DCMA Manual 2201-03, DCMA administrative contracting officers (ACOs) must settle any questioned direct costs.” One problem is that DCMA Manual 2201-03 does not indicate whether DCMA DACOs have the authority to settle direct costs. It only states 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 actual responsibility for settling DCAA questioned direct costs relating to one or more of their contracts.

Thus, DACOs/CACOs are expressly responsible for (1) coordinating and (2) obtaining settlement results from other contracting officers, but they do not have express responsibility and/or authority to settle questioned direct costs on their own. That’s the job of the other contracting officers—typically an ACO. The DACOs and CACOs are busy settling indirect cost rates, negotiating Forward Pricing Rate Agreements, and administering CAS.

One problem here is that DCAA issues one “incurred cost” audit report that covers both indirect cost rates and direct costs. The findings in that audit report must be bifurcated so that each contracting officer can adjudicate, negotiate, and/or settle the questioned costs. One (or more!) ACO looks at the questioned direct costs while another ACO looks at questioned indirect costs.

We ended the previous article by asking whether DCAA should have been looking at both direct and indirect costs in the same audit? Should DCAA really be conducting two separate audits

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and issuing two separate audit reports to two (or more!) groups of contracting officers?

The Section 809 Panel thought so, and they recommended that DCAA change course. Had DoD adopted that recommendation, we'd have a lot less confusion about settlement roles and responsibilities, in our view. We discussed the relevant Section 809 Panel recommendations in [this article](#).

To be clear, here is what the Section 809 Panel had to say about DCAA's audit of contractor incurred costs. (Reference Panel Report, Volume 1, Recommendation 15.)

The term *incurred cost proposal* is not defined within federal acquisition regulations, the effect of which has been to create unnecessary burdens on both the Government and contractors. Incurred cost proposal is the government contracting community's shorthand way of referring to a contractor's final indirect cost rate proposal. An annual final indirect cost rate proposal, the elements of which are defined in FAR 52.216-7(d), is necessary for the contractor and the government to establish final indirect cost rates for purposes of settling provisionally billed (i.e., estimated) indirect costs on flexibly priced contracts. The government's responsibilities for negotiating or establishing final indirect cost rates is set forth in FAR 42.705.

Although the final indirect cost rate proposal necessarily includes details regarding all contract costs (indirect and direct), direct costs are included because (a) the government needs to verify the completeness and accuracy of the contractor's total costs to avoid double-counting and (b) direct costs are the most common means by which contractors allocate indirect costs to contracts. A final indirect cost rate proposal is not a claim for direct costs incurred and billed during contract performance. FAR 42.702 indicates that an audit of the final indirect cost rate proposal is performed for the sole purpose of negotiating final indirect cost rates.

In recent years, DCAA began auditing direct costs, as well as indirect costs, during its incurred cost audits. Before then, DCAA's audit procedures concerning direct costs were limited to verifying their completeness such that final indirect cost rates are calculated accurately. In general, expanding the scope of incurred costs audits may increase the time it takes DCAA to complete incurred cost audits and increase the time it takes contracting officers to address and resolve the results of DCAA's audits.

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The allowability of contractor direct costs is also an important compliance requirement. It is not, however, the purpose of DCAA's evaluation of contractor final indirect cost rate proposal.

Rather, a contracting officer may request DCAA to audit the direct costs of a contract pursuant to FAR 52.216-7(g), which is an entirely different oversight request than a final indirect cost rate proposal audit. If DCAA performs adequate voucher reviews, which has always been one of DCAA's important responsibilities, there should be no cause for concern.

(Emphasis added.)

The Section 809 Panel recommended that DCAA perform two separate audits—one on the contractor's indirect cost rates, and the other on the contractor's claimed direct costs. Had DoD implemented that recommendation, we don't think there would be the current level of confusion regarding which contracting officer is responsible for settling what.

Exactly what confusion are we talking about? Well, back to the DoD IG report

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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.

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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.

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Why? Let's quote from the audit report:

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DCMA lacks adequate guidance for identifying and coordinating with other contracting officers who are responsible for settling questioned direct costs. 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.

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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 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.

According to the IG auditors—

FAR 42.302(a)(9) does not prohibit DCMA DACOs from having the authority to settle direct

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costs. The [DPC] 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. 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.

Well, that's a bit misleading, isn't it? We mean, since all direct costs must bear their proportionate share of indirect costs, it really doesn't matter at all whether those direct costs are allowable or unallowable. The indirect cost rate is exactly the same, either way. Thus, either the DoD IG auditors do not understand the requirements of CAS 405 and FAR 31.201-6, or they chose to ignore those requirements when writing the audit report.

The DCMA Director disagreed with the audit findings. The audit report states—

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.

Naturally, the DoD IG auditors disagreed with DCMA's position, citing to FAR 1.102-4(e), which basically states that any action in the best interests of the Government may be taken unless expressly prohibited. Since the FAR does not expressly prohibit DCMA ACOs and DACOs from settling DCAA questioned direct costs, they should do so.

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More importantly, the DoD Inspector General believes that the failure of those DCMA “contracting officers” to use their implied authority to settle questioned direct costs is a valid reason to criticize them.