

DCAA Takes on Firm Full of Statisticians, with Statistically Predictable Results

Written by Nick Sanders

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Recently, DCAA has had its troubles supporting cost disallowances associated with executive compensation. In February, we [wrote about](#) the appeal of *J.F. Taylor, Inc.* before the Armed Services Board of Contract Appeals (ASBCA). More recently, the ASBCA heard another executive compensation appeal. Slightly different facts and issues; same result. As was the case with the first claim, DCAA's audit methodology was sharply criticized and found lacking, and the contractor's appeal was sustained.

In *J.F. Taylor, Inc.*, we reported that testimony from the Government's expert witness was given "little or no weight" by the ASBCA Judges. In contrast, the contractor's expert witness was able to convince the Judges that DCAA's methodology for evaluating the reasonableness of the contractor's executive compensation suffered from nine separate errors. The presiding Judge wrote that DCAA's methodology was "fatally flawed." The majority of the costs questioned and disallowed by the Government were found to be reasonable and, hence, allowable.

In the [current case](#), *Metron, Inc.*, DCAA had not only found some of the company's executive compensation to be unreasonably high, but it had issued Form 1 cost disallowances in the amount of roughly \$1.1 Million. The cognizant Administrative Contracting Officer (ACO) issued demand letters for about \$700,000 representing the DOD portion of Metron's "unallowable" compensation costs.

As readers know, when a contractor's cost is challenged as being unreasonable, the contractor bears the burden to show that the cost is, in fact, reasonable in amount. It is not enough to show that DCAA's methodology was flawed; the contractor must convince the Judges that the costs in question meet the FAR 31.2 definition of "reasonableness". That was Metron's challenge. Fortunately for Metron, it had a number of statisticians and mathematicians on staff who could not only show where DCAA erred, but also show why the company's position was correct. Metron met its burden of proof and its appeal was sustained.

It is fairly axiomatic that independent salary surveys are used to support the reasonableness of contractor salaries. Metron only used one survey (the "Radford Survey") to benchmark its executive salaries. In contrast, DCAA used other surveys in addition to the Radford Survey. Metron provided DCAA with an extensive justification regarding why use of the single Radford Survey was appropriate. That justification was written by two Metron executives: one of whom had a B.S in Mathematics, a M.S. in Statistics, and a Ph.D. in Statistics, while the other had a B.S, M.S., and Ph.D. in Mathematics. In contrast to Metron's well-justified methodology, the

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ASBCA Judges found that the addition survey data used by DCAA “were not sufficiently comprehensive, reliable, relevant to Metron’s industry, and/or the job matches were not sufficiently similar and representative to warrant material reduction of the results obtained from the use of the Radford Survey data alone ...”

DCAA auditors also adjusted the Radford Survey results for various reasons, with the result that the allowable Metron incentive compensation was lower than it otherwise would have been. Metron’s expert witness took issue with DCAA’s adjustments, but so did the Government’s expert witness. Both experts “rejected” DCAA’s adjustments. In addition, Metron’s executives also performed statistical analyses that “persuasively demonstrated” to the Judges that the Radford Survey data would not support the kind of regression analysis used by the Government expert to support DCAA’s findings.

The parties also disputed whether Metron’s Senior Engineers were executives, or whether they were mid-level project managers. Apparently, because the Senior Engineers lacked the title of Vice President, DCAA believed they were not executives—but Metron’s expert noted that DCAA auditors “conducted no substantive interviews of any of the executives ... and failed to understand Metron’s needs for executive talent or how it accomplished its business mission.” The Judges found that, based on their duties and responsibilities, the Senior Engineers were, in fact, executives—even though they lacked an executive-like title.

When evaluating Metron’s financial performance, DCAA auditors ignored a \$950,000 “voluntary contribution” to its profit-sharing plan. (The contribution was treated as an unallowable cost by Metron.) Had Metron not made the payment, its corporate profits would have been that much higher. However, DCAA auditors refused to increase corporate profits by the contribution, which had the effect of lowering the company’s financial performance. This was an error on DCAA’s part, according to *both* Metron’s and the Government’s expert witnesses.

The Judges also found that DCAA’s “fragmenting” of the contractor’s total revenue in order to apportion it to various organizational “divisions” (which allegedly would help assess the reasonableness of the compensation of the executive in charge of the division) was unsupportable.

The ASBCA Judges found that Metron had supported the reasonableness of the compensation of its executives, even though the compensation was above the 50 percentile in

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the Radford Survey. It rejected nearly every aspect of DCAA's comparison methodology.

To conclude, many contractors have suffered over the years at the hands of DCAA's compensation analysts. But it is the rare contractor who has both the backbone and expertise to litigate the matter. Metron was in the enviable position of having several high-powered mathematicians and statisticians on staff, which helped the contractor immensely in its battle with the Government.

As the two recent ASBCA cases show, DCAA's compensation evaluation methodology is generally flawed and does not lead to correct assessments of compensation reasonableness. However, as we noted above, it is not enough to show the flaws in DCAA's methodology; contractors must also have strong support to demonstrate why their compensation is reasonable. For those contractors who feel strongly that their position is in the right, the battle is difficult, but it can be won.