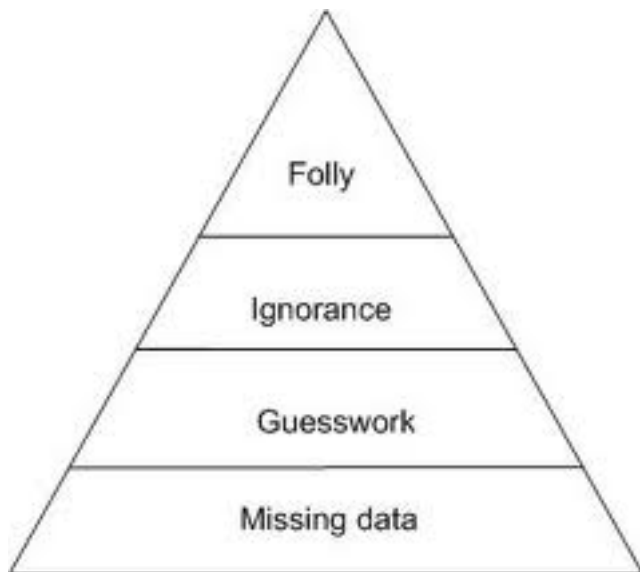


New DOD Audit Approach Concerns DOD Inspector General

Written by Nick Sanders

Tuesday, 27 November 2012 00:00



You know (because we've told you) that in September, 2010, DOD changed its approach to auditing cost proposals received from bidders. Formerly, nearly every proposal for which the contracting officer requested "field pricing assistance" was audited by DCAA. Now, the expected dollar value and the anticipated contract type determine whether or not DCAA will perform an audit. Generally speaking, DCAA only audits proposals for firm, fixed-price contracts if the value is expected to be more than \$10 million, and it only audits proposals for cost-reimbursement contracts if the value is expected to be more than \$100 million. For other (smaller, assumed-to-be-less-risky) proposals, the DCMA contracting officer is on his or her own.

If you are DCAA, the benefit of this new approach is that your pipeline of to-be-audited proposals—which are deemed to be high-priority "demand" assignments that pull auditors off other, more long-term assignments—has shrunk significantly, leaving you free to focus your resources where you want them. If you are DCMA, the benefit of this new approach is that you can now bypass the lengthy and sometimes not-so-helpful DCAA audit, and award contracts to your winning bidders more quickly—a situation that ought to please [Frank Kendall](#).

You might be thinking that DOD's new approach is a "win/win" and everybody should be happy. But not quite everybody is sporting a Cheshire cat-like grin. There's at least one stakeholder who's concerned that the new approach might be less than optimal.

If you're DCAA, then you're golden. If you're DCMA, you see a small, yet distinct, silver lining in the new situation. But if you are the DOD Inspector General, you might see a downside to

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the new approach. You might notice what Apogee Consulting, Inc. predicted—there is now a rather largish amount of proposed costs that are *not being audited* by DCAA under the new approach.

If you are the DOD IG, you might notice that, despite [reports at the time](#) that stated “defense officials believe the change will focus resources on high-risk areas and increase savings to the department,” the fact of the matter is that the change in audit approach did not reduce DCAA audit hours as much as initially predicted, did not help DCAA reprioritize the workload as much as initially promised and, as a result, the new approach actually led to a *reduction* in taxpayer savings. If you are the DOD Inspector General, you might well conclude that the entire initiative was poorly thought out and was, in essence, a mistake.

Indeed, that’s *exactly* what the DOD IG concluded, in a [new audit report](#) published this month.

The DOD IG’s audit objective was “to review factors leading to the functional changes between DCAA and DCMA ... to ensure that the interests of the Department were adequately protected.” Along the way, the DOD IG provided a fascinating insight into DCAA audit management, as practiced by DOD Leadership.

The first thing that the DOD IG found was that the Defense Procurement and Acquisition Policy (DPAP) Directorate failed “to perform a business case to support the decision” to change the cost proposal audit thresholds. The audit report stated—

A business case analysis would have considered total risks to the Department, including the potential rates of return across the DCAA audit portfolio. Such an analysis would have identified that the DCAA proposal to increase the thresholds for requesting a DCAA audit will decrease the potential return on investment to the Department and taxpayer. The DPAP decision to revise DFARS PGI 215.404-2(c) halted DCAA audits of low dollar proposals and may result in a potential loss of \$249.1 million per annum in return on investment from such audits ... DPAP performing a review could also have identified that DCMA was not prepared to perform cost analysis of low-dollar proposals, ... could not report performance statistics related to their cost analysis, ... and was not positioned to replace the potential return on investment identified by DCAA prior to the revision ... Additionally, in reviewing and approving the revision DPAP did not (i) perform a cost/benefit analysis, (ii) determine a payback period, or (iii) determine a potential return on investment that would result from the proposed change.

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The DOD IG asserted that, had a proper business case been performed, it would have identified a significant reduction in DCAA-identified taxpayer savings. The DOD IG stated—

... low-dollar proposal audits returned substantially more questioned cost per audit hour (both fixed price, cost-type and combined) than other areas in the DCAA audit portfolio, including incurred cost audits and defective pricing audits. ... Reducing the questioned cost per audit hour by the estimated cost per audit hour, DCAA was achieving a potential return on investment of \$1,885 per audit hour when performing low-dollar proposal audits.

At this point, we must confess that the math does not work out as DOD IG, DCAA, DCMA, and DPAP would have it. As we've told readers before, the "taxpayer savings" game uses grossly inflated numbers. To explain what we mean: if there are three bidders and DCAA questions \$1 million per bid, DOD gets to tell Congress that DCAA just saved \$3 million. Which is bullshit, of course. Assuming DCMA picks one of the three bidders for a contract award, then DCAA just saved \$1 million, not \$3 million. Questioning costs on proposals which never result in a contract award saves taxpayers *nothing*, since no costs will ever be incurred. So let's all keep that dirty little secret in mind as we continue.

The Honorable Shay Assad, former DPAP Director (and now Director of DOD Pricing), told the DOD IG that he made the decision to agree to DCAA's request to change the audit thresholds in order to focus the audit agency's limited resources on high-impact audit areas. According to the DOD IG—

The former Director, DPAP advised the OIG that the decision to approve the revision to DFARS PGI 215.404-2(c) was a 'resources decision'. He reasoned that DCAA does not have unlimited resources and the issue he confronted was how to reduce the number of audits DCAA was performing. In making this decision, he indicated that he was looking for ways to direct DCAA's limited resources to what he considers DCAA's most important work: large dollar value contractor proposals, incurred cost audits relating to the backlog of DoD contracts awaiting final close-out, and defective pricing audits. He advised the OIG that senior procurement executives in the Department continue to seek more timely responses from DCAA on contractor high-dollar proposal audits and that contractors have voiced concerns about unpaid contract withholding fees caught up by the DCAA backlog of incurred cost audits.

Mr. Assad acceded to DCAA's request based on DCAA's estimate that it would save 211,191 audit hours annually, which would then be available to support audits in more important areas, including "incurred cost audits ... and defective pricing audits." However, as soon as the change was approved, DCAA changed its ground rules, according to the DOD IG, who stated—

DCAA decided to continue performing audits on under-threshold subcontract proposals where

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the subcontract is included in an over-threshold prime contract proposal that DCAA is also auditing [which] reduce[d] the estimated savings from 211,191 hours to 132,133 hours.

So not only did the new audit approach reduce reported “taxpayer savings,” but it also did not free up nearly as many hours as had been initially estimated. And speaking of lost “taxpayer savings,” the DOD IG found that the new proposal audit thresholds resulted in a loss of \$249,070,705 in potential savings—that’s just about a *quarter billion dollars in lost savings* (using DOD’s B.S. approach to calculating “taxpayer savings”).

The DOD IG also ranked DCAA’s audit activity by questioned costs per audit hour. Now, we don’t agree that that’s the right metric to use—but it’s clearly the one that DCAA *itself* is currently using to assess its own performance. Based solely on the single metric of questioned costs per audit hour, the DOD IG found that Mr. Assad’s “most important” audit areas did not have the same bang for the buck (or return per audit hour, if you will) as the proposal audits that DCAA no longer performs. We found the following information to be very interesting. (Note: all information is DCAA FY 2009.)

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Defective Pricing audits returned \$633 in questioned costs per audit hour expended.

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Incurred Cost audits returned \$196 in questioned costs per audit hour expended.

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CAS compliance audits returned \$375 in questioned costs per audit hour expended.

DCAA, DPAP, and DCMA did not concur with the DOD IG audit findings, as might have been expected. For example, DCAA told the DOD IG that—

... using questioned cost per hour as the sole basis for allocating audit resources ignores areas of risk. DCAA provided that certain audits are required by law or regulation DCAA identified its incurred cost backlog which has quadrupled to \$573 billion in the last 10 years as an important area of risk. DCAA responded that postponing these incurred cost audits any longer puts the

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Department at risk for canceling funds and may allow any overpayments made to contractors to go undetected. DCAA also responded that it must perform defective pricing audits before the statute of limitations runs out.

DCAA also non-concurred with the DOD IG estimate of lost taxpayer savings. It told the DOD IG—

... DCAA responded that this amount is significantly overstated. According to DCAA, contracting officers do not always sustain DCAA questioned cost and not every proposal that DCAA audits results in a contract award. DCAA provided that the average net savings rate for audits of fixed price contracts for the fiscal years 2009 through 2011 is approximately 41.8 percent. DCAA responded that 'using essentially the same DoDIG methodology, combined with this average net savings rate, yields a much more modest potential loss of \$122.4 million.'

In response, the DOD IG wrote—

We find that the alternative measure of 'net savings' that DCAA used to calculate a 'much more modest' potential loss of \$122.4 million to the taxpayer is as a good measure of contracting officer performance in settling DCAA questioned costs as it is a measure of DCAA performance. DCAA in its response stated that contracting officers have sustained an average of 41.8 percent of DCAA questioned cost during the fiscal period 2009 through 2011, which indicates that in contract negotiations contracting officers are sustaining just over \$4 for every \$10 in DCAA questioned cost. DCAA did not indicate whether it considers a 41.8 percent sustention rate as a good indicator of the viability of its reported questioned cost. This area will be considered for future study.

Finally, the DOD IG questioned the entire strategy of eliminating DCAA audits of an entire stratum of low-dollar value proposals. It asserted that the strategy simply shifted the workload to DCMA Contracting Officers, who were already overworked and not prepared to perform the additional cost analysis work. The DOD IG pointed out that nobody in DOD Leadership chose to address that particular finding, writing—

Lastly, we find that DP and DPAP did not demonstrate why they chose to direct Department and taxpayer resources to DCMA to perform a job DCMA was not prepared to perform when DCAA had the existing infrastructure in place to get the job the done. A formal business case analysis could have identified that it was advantageous and more economical to direct any increase in DoD resources to the organization that already had the existing infrastructure to adequately perform proposal evaluations and track the questioned costs.

We here at Apogee Consulting, Inc. have previously reported on GAO findings that implicated DCMA management. Now we have a report from the DOD Inspector General that implicates DOD and DCAA leadership. We're not saying that these reports are so damning that the

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people called out by them should be fired. But we do believe that these reports are so damning that the people called out by them should consider resigning their positions, and letting more effective leaders take their turns in the batter's box.