

## Questioning Questioned Costs

Written by Nick Sanders

Friday, 21 December 2012 00:00

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As we've reported before, the number one metric by which DCAA measures its effectiveness as an audit agency is the amount of "questioned costs" that its audits generate. To be clear, DCAA does not often disallow costs on its own. Instead, it "questions" costs in an audit report that's addressed to a customer (typically a DCMA contracting officer), and then it's up to that customer to officially disposition the audit findings—including disallowing questioned costs when warranted. The ratio of contracting officer-disallowed costs to DCAA's questioned costs is called the "sustention rate". The higher the sustention rate, the more it can be said that the customer agreed with the audit findings.

Many observers disagree with DCAA's management approach. They believe that it is not only the gross amount of questioned costs that should be measured, but that the sustention rate needs to be measured as well. For example, when DCAA [told](#) the DOD Inspector General that it "non-concurred" with IG findings that DCAA was leaving a quarter-billion dollars in questioned audit dollars on the table each year, it revealed that the sustention rate for those "forward pricing audits" was 41.8 percent. In other words, "in negotiations contracting officers are sustaining just over \$4 for every \$10 in DCAA questioned costs."

Some people think that's a pretty *pathetic* result—especially in the current contracting environment, where any DCMA contracting officer who disagrees with DCAA audit findings is likely to find him or herself before a Review Board, who will adjudicate the disagreement after reviewing a lengthy written package. Some people think that, in this environment, a sustention rate of 41.8 percent ( *i.e.*, where the customer disagrees with audit findings nearly 60 percent of the time) indicates some serious audit quality issues. Those audit quality issues are, of course, in addition to the well documented audit timeliness issues with which DCAA currently struggles.

Some might also assert that a sustention rate of just over 40 percent indicates that DCAA is padding its audit findings, and that the audit agency is questioning costs simply for the sake of questioning costs—knowing that the costs it questions will never be sustained. And it need not even be that intentional. If the auditors in the field thought that they were being measured solely on the basis of the amount of costs they questioned, then it would simply be human

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nature to want to question more costs, or to push the envelope regarding which costs should be questioned. We all want our bosses' approval, and what better way to get it than to excel at the most important agency metric?

Yes, we understand that GAGAS—Generally Accepted Government Auditing Standards—should operate to ensure that audits are conducted with impartiality, independence, and objectivity. But you know what? Auditors are people too. People with all the human foibles endemic to any bureaucracy. You tell them that generating questioned costs is the most important thing in the world, and you are very likely to get questioned costs—lots and lots of them.

If you are a contractor, you should be concerned that DCAA's recent penchant for generating lots and lots of questioned costs is going to put you in a tough position. You either agree with DCAA's audit findings (thus eroding your profits), or you try to convince your cognizant federal agency official that DCAA is wrong. And if you can't convince your CFAO to override DCAA, then you've got to pay up or litigate.

We thought we would look at some of the costs that DCAA is questioning these days, courtesy of the recently issued DOD Inspector General's [Semi-Annual Report](#) to Congress, covering the six month period ending September 30, 2012. Appendix G of the Semi-Annual Report lists "Contract Audits with Significant Findings". Here are some selected "significant findings" generated by DCAA from that Appendix G list.

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Audit Report 02211-2006S10100001 was an audit of a corporate incurred cost proposal (*i.e.*, a proposal to establish final billing rates) for the contractor's FY 2006. (Note that the audit report was issued just a hair under the Contract Disputes Act's six-year statute of limitations, in April, 2012.) DCAA questioned \$33.3 million, including \$24.8 million of "medical expenses due to ineligible dependents." Our opinion on *that* particular issue is well documented on this blog.

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Audit Report 02161-2011G10110001 was an audit of travel costs billed to a single Army contract. DCAA questioned \$21.7 million—100% of all billed contract travel costs—because

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“the contractor did not obtain advance written approval for the travel as required by contract terms.” And yet—the customer apparently approved the invoices containing the travel costs; and (apparently) the customer received benefit from the contractor’s travel. (Can anybody say *quantum meruit*?)

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Audit Report 02701-2006A10100003 was an audit of a contractor’s incurred cost proposal for the contractor’s FY 2006. (Again, note the timing; in this case, the audit report was issued July 31, 2012.) DCAA questioned \$76.6 million, including \$60.1 million of “direct material for which the contractor did not provide documentation of government inspection and acceptance and/or documentation demonstrating the material costs were based on competitive awards.” While we are of course unaware of the specific details of this contractor’s situation, we find it *odd* that government inspection and acceptance would be required for contractor-acquired material. Can’t contractors have their own receiving inspection and acceptance? Even so, one would think that the customer inspection and acceptance of the end product would have sufficed. And as for the notion that material costs must be based on competition in order to be allowable ... we are *concerned* that DCAA’s position could have survived a supervisory review.

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Audit Report 04911-2010J10100001 was an audit of a NASA contractor’s “final allocated direct cost report.” DCAA questioned \$78.6 million, including \$30.5 million in “questioned subcontract costs due to inadequate price competition, failure to evaluate cost overruns, and rework costs that should have been absorbed by the subcontractor.” In addition, DCAA questioned \$20 million of health and dental insurance costs “because the contractor lacks adequate documentation and internal controls to verify eligibility.” Again with the ineligible dependents issue; notice how the lack of internal controls led to questioned costs. That’s a new twist, as far as we can tell.

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Audit Report 04911-2006B10100001 was an audit of a contractor’s FY 2006 incurred cost proposal (issued September 19, 2012) in which DCAA questioned \$58.2 million in claimed costs. Among the questioned costs were \$21.6 million of “unauditable subcontract costs because the subcontractors are no longer in business and/or the records are unavailable.” *Well*. We think that if DCAA is going to delay performing its audits, it is hardly the contractor’s fault if the subcontractor went out of business in the meantime. (Can anybody say “*laches*”?) Further, DCAA questioned \$2.9 million of “medical insurance costs due to lack of supporting documentation for the eligibility of claimed dependents.” Notice how DCAA has cleverly reversed the burden of proof there? Normally,

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in order to assert that a cost is unallowable, the government bears the burden of proof; in this case, DCAA has asserted that the contractor has the burden to prove that a cost is allowable. *Wrong!*

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Audit Report 06271-2002A10100103 was an audit of a contractor's FY 2002 incurred cost proposal—issued *more than ten years* after the contractor submitted its proposal. DCAA questioned \$4.9 million in claimed subcontractor costs “which were not adequately supported with documentation to verify that services had been received.”

Yes

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*We assert that it is not.*

Apparently, DCAA disagrees and thinks that 10 years is just the right amount of time to retain documents, despite what the FAR requires.

To be fair, we cherry-picked the audit findings reported above. There were a number of other findings that might well be legitimate, and which will likely save the taxpayers considerable sums of money. But the thing is—DCAA is obviously cherry-picking its findings, so we think turnabout is fair play here.

So if you agree with us that most, if not all, of the findings we reported above reek of auditors desperate to generate questioned costs at any price, then perhaps you'll be better prepared the next time DCAA comes calling.

One final item, which we report with some trepidation. We have received a report that DCAA HQ is inflating the questioned costs reported by its auditors. It's (allegedly) not enough that the auditors are reaching and pushing the envelope in order to generate loads of questioned costs; apparently HQ is piling additional costs on top of the auditors' findings. HQ is (allegedly) doing this by *counting as questioned costs items that the contractor has voluntarily withdrawn prior to the audit*. Our sources say, “DCAA's OWD group massages all the numbers at HQ ... if only you could get them to show the public how much of our CQ is not found by DCAA [because] they are voluntary deletions [by the contractor].” In other words, the more the contractor complies with the FAR allowability requirements, the more questioned costs that DCAA reports as audit-generated taxpayer savings.

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Now let's just say this allegation is, as of this writing, unconfirmed by official sources. But if true, it would add a new level to our little discussion of DCAA's number one management metric, would it not? One might perhaps believe that new heights in Kafkaesque management had been reached.