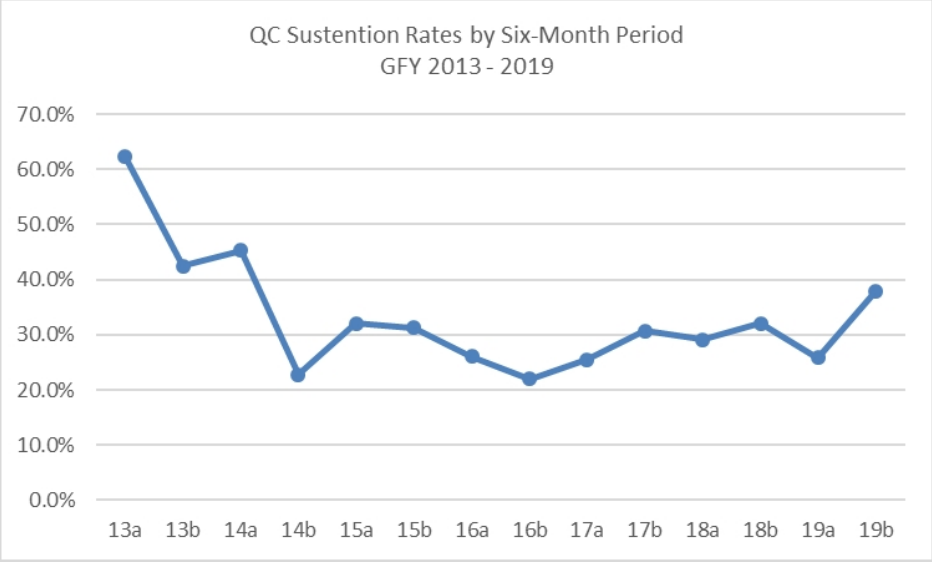
You know—if you've been reading this blog for any significant length of time—that one of the most important metrics that indicates the quality of DCAA audit findings is the contracting officer sustention rate. That is the percentage of DCAA auditor questioned costs (QC or sometimes CQ) that survives negotiation with the contractor. Those negotiations are part of the indirect rate settlement process—i.e., the process by which billing rates become *final billing rates*. (See the Allowable Cost and Payment clause, 52.216-7, for details.) Final billing rates are used for preparing final invoices on flexibly priced contracts and thus are a key element of contract close-outs.

You know about the importance of that metric. Importantly, DCAA management knows about it as well. As we've been asserting for some time, pressure is being exerted on contracting officers to sustain DCAA QC, so as to indicate that auditors are doing a better job than historically has been the case. The chart below illustrates the fall of sustention rates, a plateau at about 30%, then a sharp increase as pressure has been exerted in the past few months.

Chart 1 – Sustention rates by Six-Month Increment GFY 2013 – 2019



Source: DoD OIG Semi-Annual Report to Congress, Appendix F

Note that DCAA's sustention rate is still below 40%, but we can project that it will break that level in the near future as pressure continues to be applied to DCMA contracting officers to sustain DCAA QC audit findings.

Evidence of the pressure being applied is more than anecdotal (though there's plenty of anecdotal evidence). The evidence is found in the DoD OIG audit reports, pointing the finger at DCMA contracting officers for failing to sustain DCAA audit findings. In fairness, the reports don't actually say that. What they say instead is that "DCMA contracting officers did not document adequate rationale for disagreeing with $219 million in DCAA questioned costs" and that "contracting officers did not adequately justify why they reimbursed the [QC] to the DoD contractors."

Let's look at DoD OIG Audit Report No. **DODIG-2020-036** , dated 30 November 2019.

The DoD OIG auditors selected 21 DCAA audit reports issued between October 1, 2015, and March 18, 2018. In those 21 audit reports, DCAA questioned (in the aggregate) $750 million. With respect to two of the 21 selected audit reports, the OIG auditors found that –

DCMA contracting officers did not document adequate rationale for disagreeing with DCAA questioned costs totaling $219 million. DCAA primarily questioned the costs based on the contractor's failure to provide supporting documentation for the claimed costs, as FAR 31.201-2, 'Determining Allowability,' requires. The DCMA contracting officers documented one or more of the following reasons for not sustaining DCAA's recommendation to disallow the questioned costs:

- The required time periods for the contractor to retain any of the records had lapsed.
- The questioned costs in the audit report were identical to those disputed before the Armed Services Board of Contract Appeals (ASBCA), which rendered an opinion against the DCAA questioned costs.
- No action on the audit report was required because DCAA had disclaimed an audit opinion.

However, none of these reasons adequately justify the contracting officers' decision not to

sustain the DCAA questioned costs.

The OIG auditors found that the DCMA contracting officer's rationale for not sustaining the DCAA auditors' QC was invalid. But before we discuss the OIG's rationale, let's take a moment and point out that the 21 audit reports selected all had one thing in common: in each of those 21 audit reports, *DCAA had disclaimed an opinion*.

What does that mean? As stated in the OIG audit report, "DCAA disclaims an opinion when it is unable to perform all audit procedures considered necessary to obtain sufficient appropriate evidence and conclude whether any noncompliances are material and pervasive." Thus, in these 21 audit reports, DCAA expressly stated that the auditors were unable to obtain sufficient evidence to support their opinions.

That situation didn't keep DCAA from reporting those opinions anyway.

As the OIG audit report noted, "when DCAA disclaims an opinion, it still has an obligation to report to the contracting officer any proposed costs that it determines are not allowable on Government contracts." Let's look at that assertion.

The DCAA Contract Audit Manual (CAM) states, at 2-102.2—

f. A disclaimer of opinion is issued when there are scope restrictions and the departures from GAGAS requirements are so significant that the examination has not been performed in sufficient scope to enable the auditor to form an opinion. A scope restriction may be imposed by the contractor, the requestor, or by other circumstances such as the timing of the work or the inability to obtain sufficient evidence (see 10-208.5).

But there's more. Looking at CAM 2-302.3 ("Evidence") we find—

The auditor must obtain sufficient evidence to provide a reasonable basis for the conclusion

expressed in the report. This requires that sufficient procedures be performed to test the contractor's assertion to provide reasonable assurance that unallowable costs and other noncompliances with applicable Government laws and regulations are identified.

Thus, if the DCAA auditor did not obtain sufficient evidence to form a reasonable basis for a conclusion, then the audit did not comply with Generally Accepted Government Auditing Standard (GAGAS) 6.04b and the opinion must be disclaimed. But does that mean DCAA must still report to the contracting officer any costs it believes to be unallowable? Not exactly.

What the CAM states (at 10-208.7) is that, when disclaiming an opinion, "the audit report should describe the nature of any material noncompliance and its actual and potential effect on the subject matter in a 'Report on Other Matters' appendix." Suggested language includes the phrase "Reporting noncompliances do not represent an overall opinion on the subject matter under audit but are fully developed findings based on substantiated evidence from the limited procedures applied during the performance of the audit." Further, when reporting such other matters, auditors are directed to—

- Not use the structured note format in the appendix because audit evaluation section describes the audit procedures and could be misleading.

- Avoid summary exhibits showing a difference or audit recommended column.

- Avoid using the term 'questioned' costs.

- Avoid presenting calculated rates based on the report findings.

These are the circumstances presented to DCMA contracting officers in the 21 audit reports selected for review. The contracting officers were not presented with questioned costs. They were not presented with the impact of the findings on the contractors' submitted indirect rates. And they were not presented with these findings within the body of the audit report, but instead within an appendix to the audit report entitled "other matters."

Nonetheless, 19 of the 21 audit reports were dispositioned to the OIG auditors' satisfaction. With respect to the two audit reports that were not dispositioned adequately (in the auditors' judgment), the OIG auditors found some interesting rationales to support their criticism.

The OIG audit report noted that "DCAA primarily questioned [1] the costs based on the contractor's failure to provide supporting documentation for the claimed costs, as FAR 31.201-2, 'Determining Allowability,' requires." However, when the contracting officer(s) failed to sustain costs that were questioned on that basis, using the rationale that the contractor did not have an obligation to retain its records past the FAR 4.7 required time period, the OIG auditors disagreed, stating, "Regardless of the minimum record retention time periods specified in the FAR, the contractor had an obligation to support its costs claimed on Government contracts."

The audit report states—

The contracting officer … did not sustain the $209 million in questioned subcontract costs. The contracting officer documented in his negotiation memorandum that the 4-year period prescribed by FAR Subpart 4.7, 'Contractor Record Retention,' for retaining subcontract records had lapsed because the costs were incurred 7 years ago. Therefore, he concluded that it would not be fair or reasonable to sustain the $209 million in DCAA questioned costs and recoup the costs from the contractor. We disagree with the contracting officer's decision to not sustain the DCAA questioned costs of $209 million. The record retention periods outlined in FAR 4.7 identify the minimum amount of time that the contractor must maintain records to support its claimed costs.

Actually, that is not correct. FAR 4.7 establishes that the contractor's obligation to support its claimed costs ends when the FAR-specified record retention period expires. The government's audit rights continue (often beyond that period) but the contractor's obligations to retain records do not. So that's wrong. The contracting officers were correct.

Let's support our assertion a bit, with some selected quotes from the FAR:

This subpart provides policies and procedures for retention of records by contractors to meet the records review requirements of the

Government. The purpose of this subpart is to generally describe records retention requirements and to allow reductions in the retention period for specific classes of records under prescribed circumstances. This subpart applies to records generated under contracts that contain one of the following clauses:

(1) Audit and Records-Sealed Bidding (52.214-26).

(2) Audit and Records-Negotiation (52.215-2).

The retention periods in 4.705 are calculated from the end of the contractor's fiscal year in which an entry is made charging or allocating a cost to a Government contract or subcontract. If a specific record contains a series of entries, the retention period is calculated from the end of the contractor's fiscal year in which the final entry is made. The contractor should cut off the records in annual blocks and retain them for block disposal under the prescribed retention periods.

The contractor shall retain the records identified in 4.705-1 through 4.705-3 for the periods designated, provided retention is required under 4.702 . Records are identified in this subpart in terms of their purpose or use and not by specific name or form number. Although the descriptive identifications may not conform to normal contractor usage or filing practices, these identifications apply to all contractor records that come within the description.

Thus, based on the plain language of the FAR, it is clear that the OIG auditors' interpretation is wrong. The retention periods do not establish a minimum, but instead establish a *maximum*, beyond which a contractor is not required to retain its records. And the retention requirements expressly and specifically pertain to contracts that contain the 52.215-2 audit access clause. That incorrect interpretation led to an inapposite criticism of the contracting officer, in our view.

Similarly, when the OIG auditors criticized another contracting officer for failing to sustain a position found in a disclaimed opinion, we don't think much of that OIG rationale either. The OIG audit report stated—

The contracting officer … stated in the negotiation memorandum that she did not sustain the $3 million in questioned costs because she believed she was not required to take any action on DCAA audit reports that disclaim an audit opinion. In our interview with the contracting officer, the contracting officer stated her opinion that DCAA did not perform an audit and that the DCAA audit report 'was a nothing report.'

The DCMA contracting officer failed in her obligation to take appropriate action on the DCAA questioned costs, as FAR 42.705-1(b)(5)(iii) requires. The contracting officer's position is flawed because:

- although DCAA disclaimed an opinion, the contracting officer had a responsibility to take action on the costs that DCAA stated did not comply with the FAR; and
- the contracting officer did not follow the negotiation process outlined in FAR 42.705-1(b)(4). The contracting officer did not maintain evidence that she obtained adequate documentation for the contractor's costs.

Well, you know. We here at Apogee Consulting, Inc., disagree with the OIG positions above. As we stated above, there were no questioned costs and the audit report with a disclaimed opinion was indeed a "nothing report" to which the contracting officer was not required to give any deference. In particular, we strenuously object to the notion that—somehow—a contracting officer is required to reperform the failed DCAA audit procedure and "obtain adequate documentation for the contractor's costs" if the non-questioned costs will not be sustained.

Fundamentally, what the DoD OIG audit report fails to grasp is that the contracting officer is charged with using "independent business judgment" to resolve disputes. The FAR states (at 33.204) that "The Government's policy is to try to resolve all contractual issues in controversy by mutual agreement at the contracting officer's level." If the OIG auditors had there way, no contracting officer would ever deviate from the original DCAA audit position and we would all see a skyrocketing in the number of formal disputes and litigation—in direct opposition to the FAR directive.

But while we vehemently disagree with the DoD OIG's position(s), the DCMA Director was just fine with them. The audit report stated—

The DCMA Director agreed with the recommendation and will begin a review of the contracting officers' decisions not to sustain the questioned costs in the two DCAA audit reports. The Director stated that the review will also determine if the contracting officers reimbursed costs that were not allowable on Government contracts. Subsequent to receiving the Director's written comments, a DCMA senior official also clarified to us that DCMA will take reasonable steps to recoup any unallowable costs identified by the review. Additionally, the senior official also stated that DCMA will assess whether action should be taken to hold the contracting officers accountable for not sustaining any DCAA questioned costs determined to be unallowable.

Way to support your troops, Admiral.

[1] Let's note the misuse of the term "questioned" in this context, since DCAA will not question costs when the audit opinion is disclaimed. When the OIG audit report states "contracting officers must take appropriate action in response to DCAA questioned costs, even though DCAA disclaims an audit opinion," it is wrong. There were no questioned costs, since the opinions were disclaimed. It would have been nice of the DoD OIG auditors to get that nuance correct when criticizing the DCMA contracting officers.