

## Why Won't Contracting Officers Settle Questioned Direct Costs? (Part 1)

Written by Nick Sanders

Tuesday, 02 February 2021 09:06 - Last Updated Tuesday, 02 February 2021 19:49

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A couple of friends and I will be starting a podcast soon, discussing government contracting things. Looks like it will be available every two weeks. The other two participants are former contracting officers and former DAU instructors. I think the only reason they asked me to participate is for comic relief.

I'm supposed to bring "two or three topics" to each podcast. We'll see how that goes. I may be like the SNL castmember who doesn't return after their first season. Anyway, one of my topics for the first podcast will be the recent Department of Defense Inspector General audit report where – once again – the offer criticism of DCMA contracting officers for not doing what DoDIG thinks they should be doing. In this case, it concerns settlement of direct costs questioned by DCAA during their "incurred cost" audits (which should really be called audits of "proposals to establish final billing rates," but we'll get into that later in this article.)

In DoDIG Audit Report No. [DODIG-2021-047](#) ("Evaluation of Department of Defense Contracting Officer Actions on Questioned Direct Costs"), the auditors offered a conclusion regarding whether "the actions taken by DoD contracting officers on questioned direct costs reported by the Defense Contract Audit Agency (DCAA) complied with the Federal Acquisition Regulation (FAR), DoD Instructions, and agency policy."

Before we get into the audit report, though, you need to know that the DoD IG has a long history of sniping at DCMA contracting officers—most of which has been documented on this blog. This particular audit report noted that it was following-up on a 2017 audit report. We discussed that audit report in [this article](#). As with the prior audit report, in this audit report the DoD IG accepted DCAA findings as being accurate, and criticized DCMA contracting officers for not addressing DCAA's findings timely and therefore "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." *May have* being the key phrase. The IG auditors don't know. But it sure makes a good headline, right?

Here's some other stuff you need to know before we get into the audit report:

Each contract has a cognizant contracting officer (often called the "procuring contracting officer" or PCO), but contract administration functions may be "assigned" (or delegated or transferred) to a Contract Administration Office (CAO). The entire post-award contract administration

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function, or portions of it, or “specialized services” may be assigned from the PCO to the CAO. Contract administration functions are listed in the FAR, at 42.302. There are 82 of them. In addition, DFARS 242.302 lists a few more contract administration functions.

There are certain functions that are “normally delegated” to a CAO (71 out of 82) and there are certain functions that *must* be delegated to a CAO. Functions that are mandatory for delegation include:

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Negotiation of forward pricing rate agreements

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Establish final indirect cost rates and billing rates for those contractors meeting the criteria for contracting officer determination

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Administer Cost Accounting Standards (CAS) matters

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Determine the adequacy of the contractor's accounting system

Those functions must be performed by a CAO contracting officer, and not by a PCO. The rationale should be fairly obvious: those are cross-cutting issues that affect all contracts (perhaps contracts awarded by another agency) and administration of those issues requires a bigger picture than a PCO would typically get. The CAO contracting officers that handle those issues are typically called “Administrative Contracting Officers” (ACOs). But there are different flavors of ACO; some ACOs are called ACOs but others are called Divisional Administrative Contracting Officers (DACOs) and still others are called Corporate Administrative Contracting Officers (CACOs). A DACO handles cross-cutting issues for a contractor segment or division or sector (or whatever the contractor calls it) whereas a CACO handles cross-cutting issues across an entire corporation, and coordinates the activities of multiple DACOs and/or ACOs.

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One thing we've noticed is that neither the FAR nor the DFARS actually describes the role of a DACO or ACO. The regulations are silent on what those functions do and how they differ from each other. As we will see, that gap gave the DoD IG auditors some wiggle room to create audit findings.

The DoD IG audit report states, "For DCAA incurred cost audit reports, the DCMA is generally responsible for determining whether the DoD contractor's claimed indirect and direct costs are allowable in accordance with contract terms and FARs Subpart 31.2 and for negotiating a final indirect cost rate agreement that will be used to close the contractor's contracts." Now we are going to quote from the audit report because what follows is the central thesis of the DoD IG auditors:

DCMA Manual 2201-03 ["Final Indirect Cost Rates," February, 14, 2019] requires DCMA divisional administrative contracting officers (DACOs), who are usually the primary recipients of a DCAA incurred cost audit report, to settle any questioned indirect costs and prepare the final indirect cost rate agreement. According to DCMA Manual 2201-03, DCMA administrative contracting officers (ACOs) must settle any questioned direct costs. *DCMA Manual 2201-03 does not indicate whether DCMA DACOs have the authority to settle direct costs.* However, the Manual does state 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 responsibility for settling DCAA questioned direct costs relating to one or more of their contracts. The DCMA DACO and DCMA ACO are collectively referred to in this report as DCMA contracting officers.

(Emphasis added.)

Because the regulations (and DCMA guidance) are silent on the varying roles of ACOs, DACOs, and CACOs, the IG auditors felt free to lump them all together and call them, collectively, "DCMA contracting officers." When that happens, then an opportunity arises to criticize the "contracting officers" for not following guidance.

The issue is who has the authority to settle questioned direct costs. There is no question that an ACO or DACO or CACO must settle indirect cost rates. There is no question that an ACO must settle questioned direct costs. There is no question that a DACO (or CACO, we assume) must

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“coordinate” the activities of the ACOs in effectuating settlement of questioned direct costs. But do DACOs (or CACOs) have the authority to settle direct costs on their own? The guidance doesn't say. But the IG auditors will assert that they do have that (unwritten) authority, and will then criticize them for not exercising it.

The DoD looked at DCAA audit reports and examined how DCMA “contracting officers” dispositioned or settled the audit findings. The audit report stated:

We selected 26 DCAA audit reports from a universe of 68 DCAA audit reports that each questioned over \$1 million in direct costs and were reported as settled in the CAFU system by DoD contracting officers between October 2017 and September 2018. The DCAA issued the 26 DCAA audit reports for settlement between February 2006 and September 2017. In total, the 26 DCAA audit reports identified \$597.4 million in questioned direct costs because the auditors determined that the costs were unallowable in accordance with FAR subpart 31.2. Common reasons for the DCAA questioning the direct costs included instances where contractors did not provide sufficient supporting documentation of the costs or where DCAA auditors determined that the costs were unreasonable in accordance with FAR 31.201-3.

DCAA questioned nearly \$600 million in direct costs through issuance of 26 audit reports over a nearly 11-year period. But wait! *Should they have?* Should those audit reports have been issued?

Let's ask the question “should DCAA have been looking at both direct and indirect costs in the same audit?” This would seem to be a reasonable question, because of the bifurcated settlement process discussed above. Some CAO contracting officers settle indirect cost rates, and others settle questioned direct costs. Given the disparate nature and responsibilities associated with dispositioning DCAA audit findings, one might reasonably think that two audit reports would be created, addressed to the appropriate contracting officer. Such is not the case.

But should it be the case? At least one distinguished body thought so, and made that recommendation.

In the next blog article, we'll explore the Section 809 Panel's recommendations in this area, and continue our criticism of the DoD IG criticism of the DCMA contracting officers who, the auditors

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asserted, had failed to execute their (unwritten) responsibilities.