

## Questioned and Sustained Costs

Written by Nick Sanders

Tuesday, 29 January 2019 00:00

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Sometime in the next few months DCAA will issue its Annual Report to Congress. The Annual Report will be dated March 31 (covering the previous Government Fiscal Year that ended September 30, 2018), but who knows when it will appear on the DCAA website for the public to see? It's not as if DCAA has a great record with respect to timely internet publication of its documents. That said, we know it's coming, because there's a public law that requires DCAA to submit that report each year.

When the Annual Report appears, we'll look at it carefully, as we always do. We'll look at productivity statistics and we'll compare the most recent statistics to historical values. We'll look at the information in the Annual Report and match it up to the statistics in the DoD Office of Inspector General's Semi-Annual Reports to Congress for the same period. We'll try to put the current DCAA audit stats into an historical context and we'll try to draw some conclusions about what the stats are telling us.

One of the most important stats we'll look at is the Questioned Cost values as a percentage of total dollars examined. It's not really a good metric, taken alone. It doesn't really tell us much of anything about audit quality, though for a few years DCAA tried to make it seem as if it did. It doesn't really say much about taxpayer dollars saved or taxpayer dollars recovered, though DCAA would like you (and Congress) to believe that's the case. It is not really a metric that says anything about the quality of audits that DCAA is performing—since a quality audit may or may not result in findings.<sup>i</sup>

If anything, it's a metric that indicates *contractor quality*. The better job contractors are doing, the lower the CQ percentage of dollars examined should be.

So why do we care about a statistic that's not particularly meaningful?

We care about CQ statistics because they are an indicator of *risk*.

The DCAA CQ statistics can be used to make a guesstimate as to about how many dollars our clients might see questioned, on the average. If the client books a contingent liability reserve related to future DCAA audits, and lacks much history upon which to base that reserve amount, then the DCAA CQ stats are a decent place to start.

In addition, the CQ statistics are a natural benchmark. If you are experiencing significantly more CQ (as a percentage of total dollars examined)

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than the average value, you might ask yourself why that's the case. Are you more aggressive than the average contractor? Are you taking positions you know DCAA will challenge? Or perhaps you have a more aggressive DCAA auditor than the average. Perhaps you have an auditor who is taking positions that are not well-supported by the Contract Audit Manual.

On the other hand, if your CQ stats are lower than average, does it mean that you are better than average at self-disallowing costs before audit? Or does it perhaps mean that you are being overly conservative—and leaving money on the table?

In any case, it's an indicator and a benchmark. As such, it has value when analyzed and put into context.

But the real deal is the QC sustention rate. This is the percentage of QC that are actually sustained by a contracting officer. That is a more powerful indicator of DCAA audit quality.

Readers of this blog know that, because we've written about it before. Just about every time the DoD OIG Semi-Annual Report to Congress is issued, we write about QC sustention rates.<sup>ii</sup> As the DoD OIG tells Congress: "Cost Questioned represents the amount of audit exception, potential cost avoidance, or recommended price adjustment in the audit report [but] Cost Sustained represents the questioned costs, potential cost avoidance, or recommended price adjustment sustained by the contracting officer."

The CQ sustention rate is a real indicator of audit quality. It tells us the percentage of time that a contracting officer is persuaded by an audit finding. It tells us the percentage of time that a contractor is unsuccessful at persuading a contracting officer that a DCAA audit finding is wrong. It is as close to a definition of "win" or "lose" as we have.

Historically, the CQ sustention rates have not been very good, if you are a DCAA auditor. On the other hand, if you are a contractor, then they have been good news indeed. In GFY 2017, the overall QC sustention rates for DCAA audit reports issued after contract award was 29%. That means that less than one-third of all CQ dollars were sustained by a contracting officer—meaning that more than two-thirds of all dollars questioned were not sustained. The contracting officer did not agree with the audit findings. The contractor won.

DCAA management knows this. DCAA management knows that CQ sustention is the metric that matters. In fairness, it's not the *only* metric that matters. In its first Report, the Section 809 Panel recommended that DCAA report 12 metrics to Congress each year. But until that recommendation is accepted and implemented, CQ sustention is the best metric we have to evaluate audit quality. And DCAA management knows people are using it that way.

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Because DCAA management is aware of the power of that metric, contractors (and contracting officers) have started to see a not-so-subtle pressure applied from auditors to sustain findings during negotiations with contractors. Sometimes, it's not about the right or wrong of the audit finding; instead, it's about the need to report a high sustention rate to Fort Belvoir. It's about the need to create the appearance of audit quality, regardless of whether or not it is deserved.

Remember, auditors always have the ability to report contracting officers to the DoD Office of Inspector General if they believe the contracting officer is not operating with the best interests of the U.S. government in mind. The threat is that the CO will be investigated and forced to explain their position to the IG if they don't cave-in and sustain the audit finding. That threat, whether spoken or not, is always there.

As a result, we are seeing an up-tick in "split the baby" negotiations, where contractors are being asked to give in, to a certain percent, to an audit finding. Even though the contractor may believe the finding is without merit, there is pressure to give a bit so that DCAA doesn't look too bad. A "split-the-baby" 50/50 sustention is a huge win for DCAA, because it's nearly double what the audit agency has been getting, according to 2017 statistics.

What can contractors do when faced with this situation? Well, they can agree, of course. But if they don't want to agree, they have a tricky path ahead of them. They need to remind the CO that it is the CO who has the warrant—not the DCAA auditor—and, as a result, it is the CO who is charged with *independent* business judgment. It is the CO who has to negotiate a fair and reasonable solution to the differing views with which they are presented. Sometimes "splitting the baby" is appropriate; but other times it may not be.

When negotiating audit findings with a contracting officer, it's going to be helpful to keep in mind that the auditor is watching and mentally calculating the CQ sustention rate. If that value falls too far below the agency average, that auditor may get upset. That's not to say that findings without merit should be accepted in the name of relationship management. But we think it's something to keep in mind.

<sup>i</sup> Though we noted—and wrote about—a fairly recent DCAA policy shift in which audits that have no findings do not result in issuance of formal audit reports. We suspect that's a policy that focuses on reducing GAGAS noncompliance risk, rather than manipulation of audit productivity statistics.

<sup>iii</sup> Though it turns out we didn't write about the latest DoD OIG Semi-Annual Report to Congress, published in November, 2018. We'll catch up on that next time around.