Why GAO Did This Study

Federal agencies obligate billions of dollars annually using cost-reimbursement contracts. This type of contract involves high risk for the government because of the potential for cost escalation and because the government pays a contractor’s costs of performance regardless of whether the work is completed. As such, cost-reimbursement contracts are suitable only when the cost of the work to be done cannot be estimated with sufficient accuracy to use fixed-price contracts. Agencies may use this contract type only if certain conditions are met. At your request, GAO assessed (1) the extent of agencies’ obligations under these contracts, (2) the rationales for using this contract type, (3) determinations that contractors’ accounting systems are adequate for determining costs applicable to the contracts, and (4) procedures for monitoring contractor cost controls. GAO analyzed federal procurement data and contract files and interviewed contracting and other government officials.

What GAO Found

The complete picture of the government’s use of cost-reimbursement contracts is unclear. From fiscal years 2003 through 2008 federal obligations under cost-reimbursement contracts were reported to have increased $16 billion, to $136 billion, which represented a decrease in the total percentage of federal obligations over the 6-year period, from 34 percent to 26 percent. However, the overall downward trend is misleading. A significant increase has been reported for obligations using the “combination” contract type, a category that based on GAO’s analysis of 2008 data, includes many contracts with cost-reimbursement obligations that are not recorded as such. According to OFPP, a decision was recently made to eliminate the use of “combination” as a Federal Procurement Data System-Next Generation contract type, effective for all new contract awards starting in fiscal year 2010. In addition, GAO found billions of dollars for which the contract type had been coded as “missing” in fiscal year 2008.

Agencies’ rationales for using cost-reimbursement contracts were difficult to determine because contracting officers frequently did not document—even in acquisition plans—why they chose to use this contract type. The current requirement for such documentation is minimal, but recent legislation (not yet implemented in the Federal Acquisition Regulation) requires that acquisition plans address the rationale. Of the 92 contracts and orders GAO reviewed, about 30 percent did not include any documentation. The supporting documentation GAO did find generally did not explain why a cost-reimbursement contract for the specific requirement was selected. GAO also found little evidence that agency officials are analyzing contracts’ pricing history and requirements to determine if they can transition to a contract type with firmer pricing, even though experience may provide a basis for doing so.

Of the 92 contracts and orders GAO reviewed, about half had any evidence that, at least within 4 years before contract award, contractors’ accounting systems had been deemed adequate to determine costs applicable to the contract. Twenty contract files had no evidence that the contractors’ accounting systems were determined adequate and 20 other contract files contained determinations that had been made either many years before award or after the contract was awarded. Inadequate accounting systems, or accounting systems that had not been deemed adequate for many years, may result in the government making improper payments to contractors.

GAO found a range of procedures for monitoring contractor cost controls at the agencies in its review. Procedures at the civilian agencies generally call for program officials to review contractor invoices. At the Department of Defense, cost surveillance depends on contractor-reported earned value management data, supplemented with audits for the purpose of testing whether invoiced costs are allowable. GAO’s prior work has raised concerns about the effectiveness of these audits.

What GAO Recommends

GAO is making recommendations to the Office of Federal Procurement Policy (OFPP) regarding how contracts are coded in the government’s procurement database and aimed at encouraging timely analysis to determine if a transition can be made to a contract with a firmer pricing basis. OFPP agreed with the recommendations. The other agencies in GAO’s review generally agreed with the findings in the report or had no comments. View GAO-09-921 or key components. For more information, contact John Needham at (202) 512-4841 or needhamJK1@gao.gov.