



September 2017

# FEDERAL CONTRACTING

## Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog

Accessible Version

## Why GAO Did This Study

Closing contracts is a key step in the contracting process. GAO and others have previously reported that large numbers of contracts were not closed within time frames set by federal regulations, which can expose the government to financial risk. DCAA's backlog of audits of contractors' incurred cost proposals contribute to the delays in closing out flexibly-priced contracts.

GAO was asked to review the extent of the contract closeout backlog at federal agencies. In addition, a House Armed Services Committee report included a provision for GAO to assess DCAA's incurred cost audit backlog. This report addresses the extent to which (1) selected federal agencies effectively manage contract closeout, and (2) DCAA effectively manages its incurred cost audit backlog.

GAO selected five agencies based on the number of contracts awarded and dollars obligated in fiscal year 2015. GAO analyzed documents and interviewed acquisition officials to assess how contract closeout is managed. GAO also analyzed data on DCAA's incurred cost audit backlog.

## What GAO Recommends

GAO is making seven recommendations, including to each of the five agencies to develop means to track critical elements on contract closeout efforts and to DCAA to assess its efforts to reduce its backlog and establish related performance measures. Four agencies concurred, and DHS identified planned actions that could address the intent of the recommendation.

View [GAO-17-738](#). For more information, contact Timothy J. DiNapoli at (202) 512-4841 or [dinapolit@gao.gov](mailto:dinapolit@gao.gov).

## FEDERAL CONTRACTING

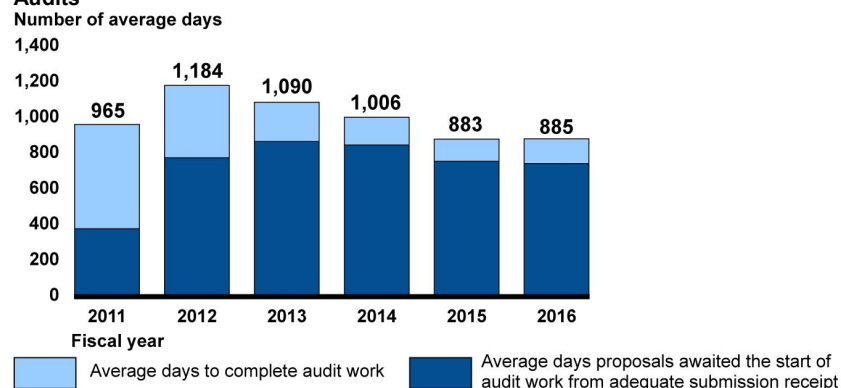
### Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog

## What GAO Found

The effectiveness of management efforts to reduce the number of contracts overdue for closeout varied across five agencies GAO reviewed—the Departments of Defense, Health and Human Services, Homeland Security (DHS), Justice, and State. None of the agencies had critical elements agency-wide that would help track and oversee contract closeout processes—the number and type of contracts to be closed, where the contracts were in the process, and goals and performance measures. Having such information could help management address the causes as to why contracts remain open and reduce the contract closeout backlog.

Since 2011 the Defense Contract Audit Agency (DCAA) has reduced its inventory of contractors' incurred cost proposals awaiting audit by about half to 14,208, and DCAA has significantly reduced its backlog of older proposals—those for 2013 and prior—as of September 2016. To do so, DCAA used a risk-based approach to reduce the number of audits and began conducting multi-year audits, in which two or more incurred cost proposals are closed under a single audit. Nevertheless, DCAA did not meet its initial goal of eliminating its backlog by fiscal year 2016, and DCAA officials stated that they are unlikely to meet its revised goal by the end of fiscal year 2018. Further, GAO found that in fiscal year 2016, DCAA averaged 885 days from when a contractor submitted an adequate incurred cost proposal to when the audit was completed. The lag was due to limited availability of DCAA staff to begin audit work, as it took DCAA an average of 138 days to complete the actual audit work (see figure).

**Average Number of Days for the Defense Contract Audit Agency to Complete Incurred Cost Audits**



Source: GAO analysis of Defense Contract Audit Agency data. | GAO-17-738

DCAA may be missing opportunities to help identify additional ways to reduce its inventory. For example, DCAA has not assessed options to reduce time to initiate audit work or comprehensively assessed how the use of multi-year audits could be improved and has not established related performance measures for both.

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## Abbreviations

ADV	Auditable Dollar Value
ATF	Bureau of Alcohol, Tobacco, Firearms and Explosives
BOP	Federal Bureau of Prisons
CMS	Centers for Medicare and Medicaid Services
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DHS	Department of Homeland Security
DLA	Defense Logistics Agency
DOD	Department of Defense
DOJ	Department of Justice
FAR	Federal Acquisition Regulation
FBI	Federal Bureau of Investigation
FPDS-NG	Federal Procurement Data System-Next Generation
HHS	Department of Health and Human Services
NDAA	National Defense Authorization Act

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September 28, 2017

Congressional Addressees

Closing out completed contracts is a key step in the contracting process through which the government obligates billions of dollars annually for goods and services. Closing contracts within expected time frames can help limit the government's exposure to certain financial risks by identifying and recovering improper payments. Timely closeout also allows agencies to deobligate and make available funds from completed contracts before the funds are canceled and returned to the U.S. Department of the Treasury.<sup>1</sup> Further, closing a contract years after the period of performance is complete can present challenges since key documentation and personnel with firsthand knowledge of the contract may no longer be available and tracking down information on these contracts becomes more burdensome and time consuming.

The Department of Defense (DOD), as well as other agencies, recently reported a large number of contracts—including firm-fixed-priced contracts and flexibly-priced contracts<sup>2</sup>—that have not been closed within the time frames typically expected under federal regulations—6 months for firm-fixed-priced contracts and up to 36 months for flexibly-priced

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<sup>1</sup>When a fixed appropriation account expires, the expired funds are no longer available for new obligations but are available for an additional 5 fiscal years for disbursement of obligations properly incurred during its period of availability. Unobligated balances of expired budget authority remain available for 5 years to cover legitimate obligation adjustments or for obligations properly incurred during the budget authority's period of availability that the agency failed to record. At the end of the 5-year period, the account is closed. Any remaining unexpended balances, both obligated and unobligated, are canceled, returned to the general fund of the U.S. Department of the Treasury, and are thereafter no longer available for any purpose. Obligations and adjustments to obligations that would have been properly chargeable to the closed account may generally be charged to any current appropriation account of the agency available for the same purpose, although the total amount may not exceed an amount equal to 1 percent of the total appropriations for that account.

<sup>2</sup>A firm-fixed-price contract provides for a contract price that is generally not subject to any adjustment on the basis of the costs a contractor incurs while performing the contract. In contrast, flexibly-priced contracts include contract types where the contract price may be adjusted based on actual costs incurred. Flexibly-priced contracts include all cost-type contracts, fixed-price-incentive contracts adjusted based on actual costs, and fixed-price-redeterminable contracts; orders issued under indefinite delivery contracts where final payment is based on actual costs incurred; and portions of time-and-material and labor hour contracts.

contracts.<sup>3</sup> Contract closeout includes a number of administrative actions, which are performed by the contracting activities within the agencies or contracting activities that have been delegated authority to perform these actions, such as the Defense Contract Management Agency (DCMA) within DOD.

One of the factors cited by agency officials in closing out flexibly-priced contracts is the delay in receiving audits of contractors' incurred cost proposals that are conducted by the Defense Contract Audit Agency (DCAA). DCAA conducts incurred cost audits to identify whether costs incurred on flexibly-priced contracts are allowable, allocable, and reasonable—information that contracting officers need to close the contracts. DCAA, however, reported an inventory of approximately 14,000 incurred cost proposals that were awaiting audit as of September 2016. The backlog of older proposals—those that were submitted prior to 2014—also affects defense contractors' ability to close their books and, according to industry representatives, is resource- and labor-intensive to support. In 2015, Congress enacted legislation that prohibited DCAA, starting in fiscal year 2016, from conducting incurred costs audits for non-defense agencies until DCAA met certain criteria pertaining to reducing its backlog.<sup>4</sup>

We were asked to review the extent of the contract closeout backlog at large federal agencies. In addition, the House Armed Services Committee report on H.R. 4909 contained a provision for us to assess DCAA's incurred cost audit backlog.<sup>5</sup> This report addresses (1) the extent to which selected federal agencies effectively manage contract closeout, and (2) the extent to which DCAA effectively manages its incurred cost audit backlog.

To assess the extent to which selected federal agencies are effectively managing contract closeout for both firm-fixed-priced and flexibly-priced contracts, we collected data from the Federal Procurement Data System-Next Generation (FPDS-NG) on the number of contracts awarded and dollars obligated on contracts for fiscal year 2015, which was the most recent year for which data were available when we began this review. We

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<sup>3</sup>Federal Acquisition Regulation (FAR) 4.804-1(a)(2) and (3).

<sup>4</sup>The National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 893 (2015).

<sup>5</sup>H.R. Rep. No. 114-537 (May 4, 2016).

selected five agencies based on the number of contracts awarded and dollars obligated—(1) DOD, (2) Department of Health and Human Services (HHS), (3) Department of Homeland Security (DHS), (4) Department of Justice (DOJ), and (5) Department of State (State). We interviewed officials at the selected agencies and collected agency-wide data at the selected agencies to the extent available. For agencies where contract closeout was not tracked at the agency-level (DOD, HHS, and DOJ), we also selected several components from the five agencies for further review to examine management of contract closeout at the component-level. Specifically,

- For DOD we selected the Army, Navy, Air Force, DCMA, and Defense Logistics Agency (DLA) based on the FPDS-NG data on the number of contracts awarded and dollars obligated on contracts for fiscal year 2015. We also used data from the Electronic Document Access system to determine the number of contracts that the DOD components administered in fiscal year 2015, and compared that to the FPDS-NG data. We determined that the data reported were sufficient for our purpose of selecting components for further review.
- For HHS, we determined that contract closeout data were available at various components within the agency. As a result, we selected a larger component based on contract dollars obligated in fiscal year 2015 for additional information—the Centers for Medicare and Medicaid Services (CMS).
- For DOJ, we determined that agency components had data available on the extent of contracts due and overdue for closeout. We selected the two largest components within DOJ, the Bureau of Prisons (BOP) and the Federal Bureau of Investigation (FBI), based on the number of contracts awarded and dollars obligated. We also selected the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) since it indicated that contract closeout data was available.

We reviewed relevant sections of the Federal Acquisition Regulation (FAR), including FAR Subpart 4.804, Closeout of Contract Files and FAR Subpart 42.1, Contract Audit Services. In addition, we reviewed agencies' guidance, policies, and memorandums on contract closeout. We also reviewed standards for internal control in the federal government,<sup>6</sup> prior GAO reports, and other agencies' Inspector General reports regarding

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<sup>6</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

contract closeout. Based on our review of the standards for internal control, we identified several critical elements to address management challenges—such as having and using information on the scope and characteristics of the backlog and setting goals and performance measures to assess progress of reducing the backlog. We interviewed senior acquisition officials at each agency and component we reviewed on contract closeout management, and the challenges and any actions the agencies have taken or are planning to take to address those challenges. We collected and analyzed relevant documentation, such as quarterly reviews and briefings to determine how agencies are managing contract closeout.

To assess management of contract closeout and agencies' insight into the characteristics of the contracts due for closeout, we collected available data on the number of contracts that could be over-age (i.e., for firm-fixed-priced contracts those that were not closed within 6 months after completion, and for flexibly-priced contracts those that were not closed within 36 months) and, when possible, a breakdown of the over-age contracts by contract type. We interviewed agency and component-level officials regarding the collection and verification process of their contract closeout data. We determined that the data reported by the selected agencies and components were sufficiently reliable for our purposes of determining the level of available detail on their contract closeout data. We also reviewed annual financial reports and discussed with agency officials the extent to which they are managing unliquidated obligations. Unliquidated obligations are those that have not yet been paid or are no longer needed to pay for goods and services. For example, unliquidated obligations can result from having excess funds on the contract or from delays in a contractor submitting an invoice for the cost of goods and services provided to the government.

For agencies for which DCAA had been responsible for conducting incurred cost audits on their behalf, we interviewed senior acquisition officials at each agency we reviewed and collected and analyzed documentation on any actions these agencies took to address the fiscal year 2016 prohibition of DCAA conducting incurred cost audits, such as contracts awarded to private auditing firms. We also interviewed members of a civilian agency working group that was formed to identify options for private firms to provide contract audit support services across the government. We also interviewed representatives from an industry association of federal government contractors to obtain their perspectives on the effect that delays in completing incurred cost audits had on their

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organizations, and DCAA's efforts to reduce its incurred cost audit backlog.

To assess the extent to which DCAA was effectively managing its incurred cost audit backlog, we reviewed applicable federal regulations, federal standards for internal control, and DCAA's Contract Audit Manual, as well as other DCAA guidance and policies to identify its procedures for prioritizing and conducting incurred cost audits. We obtained and analyzed data on DCAA's incurred cost proposal inventory, including its backlog, as of September 2016. We interviewed senior DCAA policy officials to better understand the process and considerations by which they determine adequacy and the risk associated with contractors' incurred cost proposals.<sup>7</sup>

We conducted this performance audit from June 2016 to September 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

Contracts are generally considered to be physically complete once all option provisions have expired, the contractor has completed performance, and the government has accepted the final delivery of supplies or services. Physically completed contracts should then be closed within time frames set by the FAR—6 months for firm-fixed-priced contracts and 36 months for flexibly-priced contracts. The FAR prohibits the closing of contract files if the contract is in litigation, under appeal, or where the contract is being terminated and termination actions have not been completed.<sup>8</sup> Flexibly-priced contracts take longer to close because additional steps must be taken during the closeout process; for example, audits on costs incurred and settlement of the contractor's final indirect cost rates. Contracting officers and DCAA need to ensure that costs

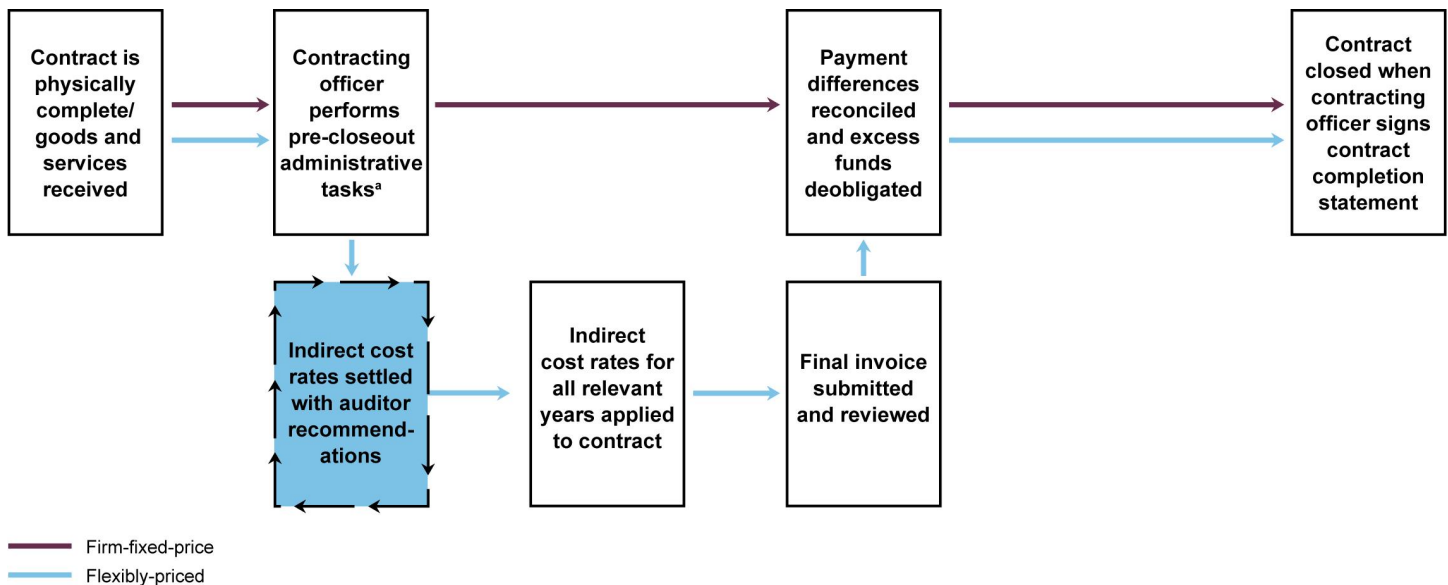
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<sup>7</sup>The FAR refers to these proposals as "final indirect cost rate proposals." FAR 42.705-1(b)(1).

<sup>8</sup>FAR 4.804-1(c)(1) and (2).

incurred by the contractor and charged to the government are allowable, allocable, and reasonable. On flexibly-priced contracts, contracting officers need to establish final indirect cost rates based on the contractor's incurred costs.<sup>9</sup> Indirect cost rates are a mechanism for establishing the proportion of indirect costs—such as a contractor's general and administrative expenses—that can be charged to a contract. See figure 1 for the contract closeout process.

**Figure 1: Contract Closeout Process**



Source: GAO analysis of federal regulations and guidance. | GAO-17-738

<sup>a</sup>Certain low-dollar, fixed-price contracts are closed using a more simplified process.

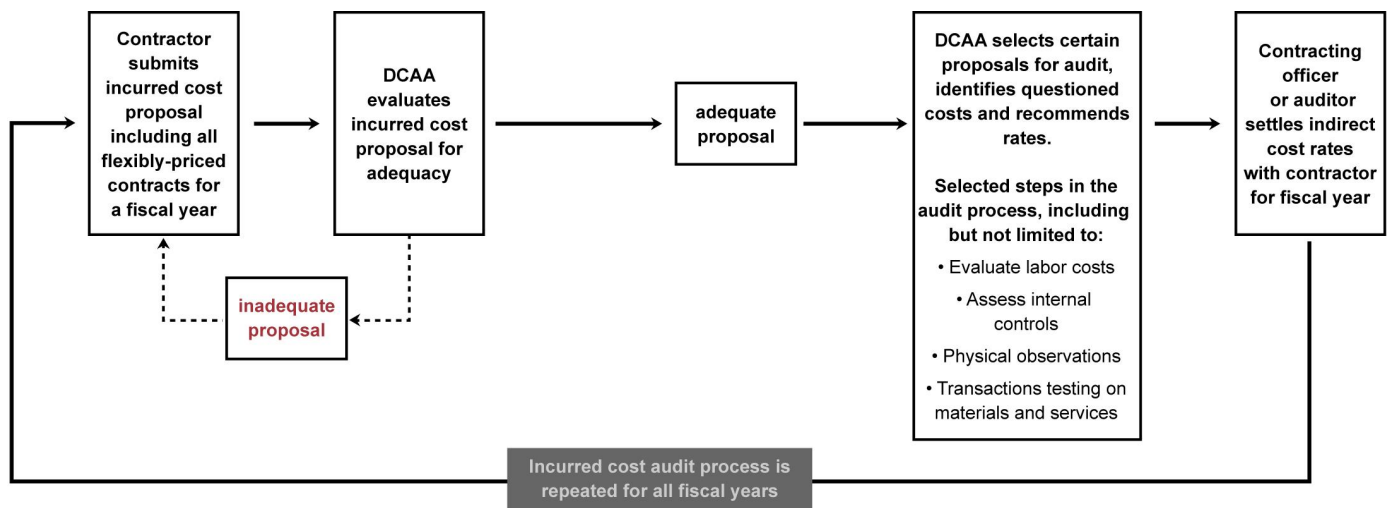
Federal acquisition regulations require contractors to submit proposals that include information on all of their flexibly-priced contracts in a fiscal year.<sup>10</sup> DCAA uses a checklist to determine whether a proposal is adequate, which, among other items, includes various cost schedules, subcontract information, and information on contracts that would be ready for closeout. DCAA may determine that a contractor's incurred cost proposal is inadequate for a variety of reasons, such as incomplete or

<sup>9</sup>Indirect cost rates can also be auditor determined. FAR 42.705(a).

<sup>10</sup>FAR 16.307(a)(1) directs the contracting officer to insert FAR Clause 52.216-7 in a contract when a cost-reimbursement contract or a time-and-material contract is contemplated. The clause requires contractors to submit adequate final indirect cost rate proposals.

inaccurate information, and request that the contractor revise and resubmit the incurred cost proposal. This process may take several iterations before the proposal is deemed adequate. DCAA categorizes the proposals based on the total value of the proposal, called the auditable dollar value (ADV), which is the sum of all of the costs on flexibly-priced contracts for that contractor during the fiscal year. Figure 2 depicts key steps in the incurred cost audit process.

**Figure 2: Defense Contract Audit Agency's Incurred Cost Audit Process**



DCAA = Defense Contract Audit Agency

Source: GAO analysis of federal and Department of Defense regulations and guidance. | GAO-17-738

There is not a one-to-one relationship between an incurred cost audit and an individual contract. In a single fiscal year, a contractor may incur costs on multiple flexibly-priced contracts, and all of these contracts would be included in the contractor's proposal. Further, since the period of performance on an individual contract may span several years, an audit of each of the contractor's incurred cost proposals for those years needs to be conducted to provide the information necessary to close one flexibly-priced contract.

## Prior Work by GAO and the Inspectors General

Our prior work has highlighted some challenges at DOD in closing out contracts, as well as challenges at DCAA regarding incurred cost audits. For example,

- In September 2009, we reported on problems with DCAA's audit quality and recommended DCAA improve audit quality guidance and develop a risk-based audit approach. DOD and DCAA generally agreed with the recommendations.<sup>11</sup> As a result, DCAA required more testing and stricter compliance with government auditing standards that added staff time to complete audits. Additionally, as DCAA's workload increased and resources remained relatively constant, auditors prioritized time-sensitive activities, such as audits to support new awards, and incurred cost audits were not completed, creating a backlog.
- In September 2011, we found that DOD's ability to close the contracts it awarded to support efforts in Iraq and Afghanistan was hindered by several factors, including limited visibility into over-age contracts and DCAA workforce shortfalls. DOD concurred with our recommendations and revised its guidance on contract closeout in a contingency environment to require regular monitoring and assessment of the progress of closeout activities.<sup>12</sup>
- In November 2011, we found that DCMA faced workforce challenges that caused delays in conducting timely quality assurance, audits of contractor processes, and contract closeout activities.<sup>13</sup> Additionally, we found that DCAA had workforce challenges that affected its ability to conduct business system audits. We recommended that DCMA and DCAA identify and execute options to assist with audits and improve transparency of the current status of contractor business systems. DOD generally concurred with the recommendations and has initiated some actions to address them.
- In December 2012, we found that DOD components—including the Army, Navy, and Air Force—did not prioritize contract closeout and had limited data on the extent of their contract closeout backlog.<sup>14</sup> We

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<sup>11</sup>GAO, *DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform*, [GAO-09-468](#) (Washington, D.C.: Sept. 23, 2009).

<sup>12</sup>GAO, *Contingency Contracting: Improved Planning and Management Oversight Needed to Address Challenges with Closing Contracts*, [GAO-11-891](#) (Washington, D.C.: Sept. 27, 2011).

<sup>13</sup>GAO, *Defense Contract Management Agency: Amid Ongoing Efforts to Rebuild Capacity, Several Factors Present Challenges in Meeting Its Missions*, [GAO-12-83](#) (Washington, D.C.: Nov. 3, 2011).

<sup>14</sup>GAO, *Defense Contracting: DOD Initiative to Address Audit Backlog Shows Promise, but Additional Management Attention Needed to Close Aging Contracts*, [GAO-13-131](#) (Washington, D.C.: Dec. 18, 2012).

also reported that DOD's efforts to close its large, flexibly-priced contracts were hindered by the backlog of DCAA's incurred cost proposals. We recommended that DOD components establish baseline data and performance measures related to contract closeout. DOD concurred with our recommendations and the components have since established performance measures on contract closeout.

The challenges faced by DOD in closing out contracts are not recent. In 2001, the DOD Inspector General issued a report that found weaknesses in the closeout process, including inadequate monitoring of contracts that could be closed, inattention to closeout requirements, and erroneous data about contracts available for closeout.<sup>15</sup>

Further, challenges in closing contracts are not exclusive to DOD. In recent years, the Inspectors General at several federal agencies, including the National Aeronautics and Space Administration (NASA), State, and the Department of Transportation, among others—have reported on the issues and challenges related to contract closeout. For example,

- In February 2014, the NASA Inspector General found that delays in closing contracts were due to the workload at DCAA, that some funds were not being deobligated in a timely manner, and that the closeout process was not uniform across the agency. For example, the Inspector General reported that contract personnel at the various NASA offices used different guidance when closing out contracts, which impaired their ability to share information and work across the agency;<sup>16</sup>
- In November 2014, the Inspector General at State found that the agency did not have systems in place for tracking contingency contracts in Afghanistan nearing completion or which had funds that were expired or were available for deobligation. The Inspector General further found that State had not established comprehensive procedural guidance for contract closeout or ensured existing guidance was accurate for these contingency contracts in

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<sup>15</sup>Department of Defense, Office of the Inspector General, *Closing Overage Contracts Prior to Fielding a New DOD Contractor Payment System*, D-2002-027 (Arlington, VA.: Dec. 19, 2001).

<sup>16</sup>National Aeronautics and Space Administration Office of the Inspector General, *NASA's Award Closeout Process*, IG-14-014 (Washington, D.C.: Feb. 12, 2014).

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Afghanistan.<sup>17</sup> According to State acquisition officials, State revised its policies and guidance regarding contract closeout. For example, the Foreign Affairs Handbook was updated to include procedures on how to address common difficulties in closing contracts;<sup>18</sup> and

- In July 2015, the Inspector General at the Department of Transportation found that the agency had not implemented oversight procedures or performance measures on contract closeout to assess whether the components were complying with closeout requirements.<sup>19</sup>

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## Effective Management of Contract Closeout Varied Across the Selected Agencies

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### Selected Agencies and Components Had Varying Levels of Contract Closeout Data and Some Established Related Goals and Performance Measures

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The five agencies and selected components we reviewed varied widely in ensuring that contracts were closed within the time frames prescribed by federal acquisition regulations. None of the five agencies we reviewed had all of the following: (1) centralized data on the number of contracts needed to be closed out; (2) information on where the contracts were in the closeout process; (3) established agency-wide contract closeout-related goals; and (4) established performance measures to assess progress toward achieving these goals. Most agencies delegated responsibility for contract administration, including closing out contracts, to their components. We found that some components within these agencies had at least three of these elements. For example, DCMA, which manages contract closeout for contracts that have been delegated to it, had each of these elements in place, while the Air Force, Navy, and

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<sup>17</sup>Department of State, Office of Inspector General, *Audit of the Contract Closeout Process for Contracts Supporting the U.S. Mission in Afghanistan*, AUD-MERO-15-14 (Arlington, VA.: Nov. 2014).

<sup>18</sup>Department of State, *Foreign Affairs Handbook*, 14 FAH-2 H-574 and 14 FAH-2 H-574.1.

<sup>19</sup>Department of Transportation Office of Inspector General, *The Department Does Not Fully Ensure Compliance with Contract Closeout Requirements*, ZA-2015-071 (Washington, D.C.: Jul. 23, 2015).

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Army each had contract closeout data and had established goals and performance measures, but lacked data on where contracts were in the closeout process. DHS also had information on the number of contracts eligible or overdue for closeout and had initiatives underway to reduce the number of low-risk, firm-fixed-priced contracts but did not have initiatives for higher risk contracts, including those involving flexibly-priced contracts.

According to the federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks. To help meet the FAR expected time frames for closing out contracts, using data on the number of firm-fixed-priced and flexibly-priced contracts that are eligible or overdue for closeout and where contracts are in the closeout process can help agencies identify where additional management attention is needed in order to close the contracts. Further, establishing goals and performance measures to assess progress toward achieving these goals can be an important tool in demonstrating leadership commitment. Having information on the scope of the issue and identifying the challenges to closing contracts could help agency-level management tailor approaches to specifically address causes as to why contracts remain open, notably if they are similar across the various components within the agency. In addition, establishing goals and performance measures ensure that sufficient management attention is paid to contract closeout. As shown in table 1, agencies varied in having each of these elements.

**Table 1: Extent to Which Selected Agencies and Components GAO Reviewed Had Available Data on Contract Closeout and Established Goals and Performance Measures**

Department/component	Does Agency or Component Have			
	Centralized data on number of contracts eligible or overdue for closeout	Information on where contracts are in the closeout process	Goals associated with reducing the number of contracts needing to be closed out	Performance measures to assess progress in achieving goal
<b>Defense</b>	<b>No</b>	<b>No</b>	<b>No</b>	<b>No</b>
Air Force	Yes	No	Yes	Yes
Army	Yes	No	Yes	Yes
Navy	Yes	No	Yes	Yes
Defense Contract Management Agency	Yes	Yes	Yes	Yes
Defense Logistics Agency	Yes	No	Yes	Yes
<b>Health and Human Services</b>	<b>No</b>	<b>No</b>	<b>No</b>	<b>No</b>
Centers for Medicare and Medicaid Services	Yes	No	Yes	Yes
<b>Homeland Security</b>	<b>Yes</b>	<b>No</b>	<b>No</b>	<b>No</b>
<b>Justice</b>	<b>No</b>	<b>No</b>	<b>No</b>	<b>No</b>
Bureau of Alcohol, Tobacco, Firearms, and Explosives	Yes	No	No	No
Bureau of Prisons	No	No	No	No
Federal Bureau of Investigation	No	No	No	No
<b>State</b>	<b>No</b>	<b>No</b>	<b>No</b>	<b>No</b>

Source: GAO analysis of agency data. | GAO-17-738

A recurring issue highlighted in our prior work, as well as in this review, is that contract closeout was not a priority for either agency management or contracting officers. Agency officials and contracting officers noted the focus for contracting officers is to award contracts for the goods and services needed to support agency operations and missions, and that closing out contracts is largely viewed as an administrative task that staff get to when time is available. Further, agency acquisitions officials we spoke with on this review noted that their ability to focus attention on contract closeout was affected by resource constraints, including workforce challenges and sequestration.

### Department of Defense

At the agency level, DOD has focused management attention on contract closeout, but does not have agency-wide data in place and does not have insight into the components' goals and performance measures. In

September 2014, Defense Procurement and Acquisition Policy established the Contract Closeout Working Group to improve and streamline the contract closeout process, including policy revisions and technology updates to its systems. DOD officials noted that while the department has limited insight as to the total number and value of contracts needing to be closed, it is the responsibility of the components and contracting offices to manage contract administration, including closeout. According to the federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—such as identifying improper payments and utilizing unspent funds elsewhere. DOD does not have the ability to track contract closeout centrally, and the components use a number of different contract management systems. The lack of insight into contracts that need to be closed, including where they are in the closeout process, hinders DOD's oversight and ability to develop targeted approaches to address the causes as to why contracts remain open—especially if there are similar issues across the agency and could make it difficult to identify areas that may need improvement. Further, without DOD oversight and monitoring of the performance measures set at the component level, DOD will not be able to assess agency-wide progress in managing contract closeout.

At the component level, we found that each of the DOD components we reviewed had data on the number of contracts to be closed and had goals and performance measures in place. However, with the exception of DCMA, the components were unable to track—and therefore address—challenges as to where contracts were in the closeout process, such as how many contracts were awaiting DCAA audits or needed action to be taken by their contracting staff. For example,

- Starting in 2013, the Army established a contract closeout task force in an effort to reduce over-age contracts. In fiscal year 2015, the Army set an overall goal of getting its over-age contracts down to 70 percent or below of the total contracts due for closeout. Further, the Army has established specific percentage goals for its contracting activities. According to the Army's Contracting Enterprise Review for the third quarter of fiscal year 2017, only one out of the Army's five

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contracting activities was on track to meet its fiscal year 2017 goal.<sup>20</sup> Overall, the Army reported that it had a total of 231,627 firm-fixed-priced and flexibly-priced over-age contracts, which constituted about 86 percent of the total contracts due for closeout. The Army does not have the data broken out by contract-type.

- In January 2016, the Navy established a goal for each of its contracting activities of reducing the number of over-age contracts by 5 percent from the end of 2016 and 10 percent cumulatively for 2017. In May 2017, the Navy conducted its first annual review on over-age contracts with its senior leadership and reported that 6 of the 10 contracting activities met the 2016 goal. Overall, the Navy reported it had a total of 74,453 firm-fixed-priced and 10,637 flexibly-priced over-age contracts as of December 2016 across its 10 contracting activities, including the Marine Corps.
- In 2015, the Air Force established a goal to eliminate its over-age contracts by fiscal year 2020. To do so, the Air Force established a goal for fiscal year 2016 of reducing the number of contracts needing to be closed out by 10 percent; in fiscal year 2017, the goal rose to 20 percent. The Air Force reported that for fiscal year 2016, the 10 percent reduction goal was met for firm-fixed-price contracts. For flexibly-priced contracts, however, the Air Force reports two categories of contracts—"cost" and "other"—and reported that it had a percentage increase of over-age "cost" contracts from 69 percent to 72 percent and an increase for "other" contracts from 82 percent to 85 percent. As of June 2017, the Air Force reported 33,844 firm-fixed-priced and a combined total of 21,036 flexibly-priced contracts due for closeout across its 15 contracting activities.
- For firm-fixed-priced contracts, DCMA established a goal of reducing its over-age contracts by 50 percent in fiscal year 2016, which it met. DCMA further established a goal that it would have no more than 869 over-age firm-fixed-priced contracts after fiscal year 2017 and no more than 350 after fiscal year 2018. For flexibly-priced contracts, DCMA established a goal from fiscal year 2016 through fiscal year 2020 to reduce its over-age flexibly-priced contracts by an additional 20 percent each year. As of March 2017, DCMA reported that it had

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<sup>20</sup>Contracting Enterprise Review quarterly briefings provide the Army's senior contracting leaders with information about the Army's contracting organizations, such as the number of contract actions they execute, obligation and competition rates, small business participation as well as over-age contracts due for closeout. According to Army contracting officials, over-age contracts due for closeout were first reported in the fourth quarter of fiscal year 2013.

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70,322 firm-fixed-priced and flexibly-priced over-age contracts and is generally on track to meeting its goals for both firm-fixed-priced and flexibly-priced contracts as of May 2017.

- DLA runs monthly reports of contracts that are recommended for closeout, and, in January 2017, DLA acquisition officials reported that 784 firm-fixed-priced contracts were recommended for closeout. Most of DLA's contracts are firm-fixed-priced contracts, with few flexibly-priced contracts. DLA has instituted a shorter goal for closing out a firm-fixed-priced contract—within 120 days—as opposed to the FAR time frames of 180 days of contract completion. DLA officials stated that the agency consistently meets this goal, having approximately 99 percent of its contracts closed within the shorter time frame. According to DLA acquisition officials, management attention over the last 2 years resulted in a reduction of the number of contracts in the backlog, with the intention of preventing another backlog from reoccurring.

DOD officials noted that DOD has several department-wide initiatives to help components address their contract closeout backlogs. For example, in December 2013, DOD implemented a policy change, increasing the obligation threshold from \$150,000 to \$500,000 for contracts that could qualify for automatic closeout. To qualify, contracts must be under \$500,000, firm-fixed-priced, and not have certain contract clauses that require contracting officers to take action, such as patents. For contracts meeting these criteria, DOD systems automatically closed these contracts. In August 2015, DOD added a contract closeout module in one of its data systems to identify and automatically close contracts that were not covered by other automated closeout processes. This initiative leverages implementation of the Procurement Data Standard across the various DOD contract writing systems to improve visibility and accuracy of contract-related data needed to determine whether automated closeout can occur. DOD reported that over 12,000 contracts were closed in fiscal year 2016 across the department using the new module.

DOD is also working to ensure that contracts closed in its contract writing systems, for example the Standard Procurement System, are reflected as closed in other data systems, such as Electronic Document Access. Further, DOD awarded a contract with the AbilityOne program in 2010 for contract closeout support services. The AbilityOne program provides career opportunities for people who are blind or have severe disabilities, including service-disabled veterans. The program also trains and employs wounded veterans to support contract closeout activities. In September 2015, DOD awarded a follow-on 5-year contract to AbilityOne to provide

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continued contract closeout support services. The contract has a not-to-exceed value of \$75 million. DOD officials stated that since it started, more than 317,000 contracts—across the various DOD components—would be closed through the AbilityOne contract as of May 2017.

### **Department of Health and Human Services**

HHS management does not have information on the extent the agency has contracts due for closeout or where contracts are in the closeout process. Having such information could help the agency in its oversight of contract closeout by identifying and addressing the causes as to why contracts remain open—such as determining if the issues affecting contract closeout are similar across the components. According to HHS acquisition officials, this information is managed at the component-level. While there is value in components tracking and managing their own progress, HHS will not be able to assess agency-wide progress in managing contract closeout without oversight and monitoring of the performance measures set at the component level. According to the federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—such as recovering improper payments or identifying unspent funds for use elsewhere.

While various HHS components reported that they are taking various actions to address contract closeout, such as establishing goals and performance measures to track their progress in closing contracts, we focused on CMS—which accounted for about 30 percent of contract dollars in fiscal year 2015 for HHS. CMS tracks the number and type of contracts that are overdue for closeout. According to senior CMS acquisition officials, in October 2014 they established a closeout goal of closing 2,250 contracts per year. In fiscal year 2016, CMS surpassed this goal and closed 2,831. As of June 2017, CMS had already met this goal for fiscal year 2017, closing 2,653 contracts and reported that it had 2,244 firm-fixed-priced and 2,867 flexibly-priced over-age contracts that still needed to be closed. In addition, CMS also issues monthly reports on contracts due for closeout that are shared among the various CMS offices. CMS acquisition officials stated that having management-level attention had a positive effect in identifying and addressing issues affecting contract closeout.

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## Department of Homeland Security

Our review found that DHS management made a commitment to address contract closeout challenges, gained insight into the extent of its contract closeout backlog, and has initiatives underway to address at least a portion of its contract closeout backlog. It has not, however, established goals and performance measures to assess its progress in reducing its contract closeout backlog.

To respond to a material weakness identified in the agency's 2014 annual Financial Report, senior DHS management initiated an effort in March 2016 to identify the extent of the department's contract closeout backlog. This effort, jointly led by the Chief Procurement Officer and the Chief Financial Officer, used DHS's contract reporting system to pull data from FPDS-NG and identify contracts that had a period of performance end date that had elapsed beyond 6 months for firm-fixed-priced contracts and beyond 36 months for flexibly-priced contracts. According to a March 2016 memorandum, DHS estimated that it had approximately 382,000 over-age contracts—those that were beyond the FAR set time frames for closeout. DHS determined that 352,000 (about 92 percent) of the over-age contracts were considered "low-risk" contracts—contracts awarded using simplified acquisition procedures or firm-fixed price contracts with the remaining 30,000 being flexibly-priced contracts.

DHS has ongoing efforts to address over a quarter of its low-risk, firm-fixed-priced contracts. From the list of 352,000 low-risk contracts, DHS financial management officials identified 5,695 over-age firm-fixed-priced contracts with unliquidated obligations of \$50,000 or less. DHS officials then verified the list of these contracts with their components' acquisition and financial management staff to verify the unliquidated obligation amounts and confirm that the contracts were ready for closeout. DHS published the list of verified contracts in a October 2016 Federal Register notice, requested contractors to submit any outstanding invoices associated with these contracts within 60 days of publication, and, if it did not receive any outstanding invoices, indicated that it planned to close the contracts. DHS acquisition officials estimated that by August 2017 about 100,000 (about 28 percent) low-risk, over-age contracts would be closed through this effort. According to the DHS officials, the initiative was focused on closing older contracts where the funds have already expired and did not collect information on the amount of funds that were deobligated off of these over-age contracts. Further, DHS acquisition officials stated that they received feedback from DHS components that

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the effort was helpful in reducing some of the administrative paperwork that allowed them to close these low-risk contracts.

DHS officials also stated that in fiscal year 2015, they implemented a separate initiative to address unliquidated obligations that targeted contracts in each DHS component with the highest amount of unliquidated obligations, which resulted in a deobligation of \$164 million from those contracts. According to the DHS officials, they also have several efforts related to flexibly-priced contracts, including efforts to coordinate with DCAA on the status of audits, developing a tool to track the audits and providing additional guidance and training to close the contracts. DHS has not, however, established goals and performance measures to assess the department's overall progress in reducing the total number of firm-fixed-priced or flexibly-priced contracts that need to be closed. Further, DHS does not have insight—either at the agency-level or the component-level—as to where these contracts are in the closeout process that would help identify where there are challenges in the process. This hinders the agency's ability to target its approaches to address the causes as to why contracts remain open and could make it difficult to identify areas that may need improvement. Additionally, without goals and performance measures, DHS officials will not be able to track progress agency-wide on closing contracts over time. According to the federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—such as recovering improper payments or identifying unspent funds for use elsewhere.

### **Department of Justice**

DOJ management does not have agency-wide information on its contracts that are eligible or overdue for closeout. Having such information could help the agency in its oversight of contract closeout by identifying and addressing the causes as to why contracts remain open. The Deputy Assistant Attorney General for Policy, Management, and Planning, who also serves as DOJ's Senior Procurement Executive, is responsible for implementing agency-wide procurement policy and other management initiatives. DOJ acquisition officials told us, however, that DOJ is decentralized, and it is up to each bureau to manage contract closeout—including the implementation of policies, monitoring closeout efforts, as well as establishing any goals and performance measures. While there is value in components tracking and managing their own progress, DOJ will not be able to track the department's overall progress

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across the agency on closing contracts or determine if the issues affecting contract closeout are similar across the components and address them at an agency-wide level without information on the number and type of contracts that need to be closed, as well as goals and performance measures. According to federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—such as recovering improper payments or identifying unspent funds for use elsewhere.

The three DOJ components that we reviewed had varying levels of information on their contract closeout backlog. For example, senior FBI acquisition officials told us that while the FBI has procedures in place for contract closeout and for removing unliquidated obligations, the FBI does not have management-level oversight on contracts that need to be closed. According to the FBI acquisition officials, the FBI does not centrally track contract closeout information and would have to go to individual contracting offices for information. The FBI accounts for about 22 percent of DOJ's contract dollars. BOP, which accounted for about 36 percent of DOJ's contract dollars in fiscal year 2015, generally lacked centralized information on the status of contracts needing to be closed out. ATF, which accounted for about 3 percent of DOJ's contract dollars in fiscal year 2015, identified 58 firm-fixed-priced contracts that had a total of approximately \$4.3 million dollars in unliquidated obligations that needed to be closed out. ATF was one of the first bureaus in DOJ to implement DOJ's Unified Financial Management System (UFMS). According to ATF acquisition officials, they use UFMS to identify contracts that need to be closed based on the elapsed period of performance date and if the contracts have unliquidated obligations. In addition, ATF has two staff dedicated to closing contracts and senior ATF acquisition officials meet quarterly to discuss the progress of contracts due for closeout. ATF does not have the ability, however, to use UFMS to identify contracts that do not have unliquidated obligations. Further, FBI, BOP, and ATF do not have specific goals and performance measures in place. Having agency-wide information on contracts due for closeout could help DOJ in its oversight of contract closeout by identifying and addressing challenges that could be similar across its components.

### **Department of State**

State management does not have information on the extent of contracts that are eligible or overdue for closeout across the agency or where the contracts are in the closeout process. Having such information could help

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the agency in its oversight of contract closeout and address challenges at an agency-wide level. Further, State has not established goals and performance measures to assess its progress in reducing its over-age contracts. While State does not have information on the total number of contracts due for closeout, in 2009 it established a contract closeout team that tracks contracts for which it provides closeout support at the request of contracting officers.<sup>21</sup> As of November 2016, the contract closeout team was working on 128 contracts due for closeout.

State acquisition officials stated that they are working to improve their ability to track when newly awarded contracts become eligible for closeout. In October 2016, State implemented a pilot to identify contracts based on the period of performance end date to identify the number of contracts ready for closeout on a quarterly basis. The pilot added new data fields into its system for contracts awarded or modified since October 2016. This is intended to help contracting officers monitor their contracts and move forward in the closeout process. The pilot ended in April 2017, and State acquisition officials expect full implementation within 18 months. While this initiative can have positive outcomes if implemented as planned, it does not pertain to contracts awarded prior to October 2016. For those older contracts, the new fields will not be applicable, limiting State's insight into those contracts. The lack of information on the full scope of contracts that need to be closed and where they are in the contract closeout process, coupled with the absence of goals and performance measures, means that State will not be able to track its progress across the agency on closing contracts over time. Further, without this information, it could hinder the agency's ability to target its approaches to address the causes as to why contracts remain open and make it difficult to identify areas that may need improvement. According to the federal standards for internal control, management should use quality information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—such as recovering improper payments or identifying unspent funds for use elsewhere.

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<sup>21</sup>The contract closeout support team is currently comprised of four people on a rotating basis and relies on contracting officers to notify them of contracts due for closeout for the team to assist with some of the administrative duties.

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## Selected Civilian Agencies' Responses to Prohibition on DCAA Conducting Incurred Cost Audits for Non-Defense Agencies

While DOD is generally required to use DCAA for contract audit support services, DCAA also provided these services to civilian agencies—including DHS, State, and HHS—on a reimbursable basis.<sup>22</sup> As noted previously, the NDAA for Fiscal Year 2016 included a provision prohibiting DCAA from performing audit support services on behalf of other federal agencies until DOD certified that DCAA had reduced its incurred cost audit inventory to below 18 months.<sup>23</sup> Starting in January 2016 DCAA notified the civilian agencies for which they had planned to do reimbursable work in fiscal year 2016 that it would no longer be able to perform audits for them until it met the statutory requirements. This affected approximately 500 audits that DCAA had planned to perform. DCAA had to coordinate with the agencies that it does work for to determine if DOD had audit responsibility over certain contractors. For contractors that did not fall under DOD cognizance, the other agencies had to identify alternate means to meet their contract audit needs.<sup>24</sup>

Several of the agencies we reviewed took actions to obtain audit services. For example, DHS established blanket purchase agreements with private auditing firms to conduct incurred cost audits for its contractors, while

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<sup>22</sup>According to DCAA policy officials, DoD Directive 5106.01 and DOD Manual 7600.07 allows for defense components to contract for audits when applicable expertise is unavailable within DOD's audit organization—such as DCAA, and to augment the audit staff if necessary, pending approval from the DOD Inspector General.

<sup>23</sup>The National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 893 (2015). In September 2016, DOD certified to Congress that DCAA had reduced its incurred cost proposal inventory below the required 18-month threshold to an average of 17.6 months. For more information about DCAA's average inventory calculation, see appendix IV.

<sup>24</sup>FAR 42.003. For contractors other than educational institutions and nonprofit organizations, the cognizant federal agency normally will be the agency with the largest dollar amount of negotiated contracts, including options. Once a federal agency assumes cognizance for a contractor, it should remain cognizant for at least 5 years to ensure continuity and ease of administration. If, at the end of the 5-year period, another agency has the largest dollar amount of negotiated contracts, including options, the two agencies shall coordinate and determine which will assume cognizance. However, if circumstances warrant it and the affected agencies agree, cognizance may transfer prior to the expiration of the 5-year period.

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State issued orders off of an existing one.<sup>25</sup> DHS acquisition officials stated that since the vast majority of DHS' contractors are also DOD contractors, the agency intends to continue to rely on DCAA for audits where it is already performing efforts for DOD and can provide a timely response. In instances where DCAA services are not available or if DCAA cannot provide a timely response, DHS plans to use the private firms for contractors for which they have cognizance. As of July 2017, DHS had not awarded any orders off of its blanket purchase agreements. State awarded four orders off of an existing blanket purchase agreement for incurred cost audit support from a private accounting firm. State acquisition officials stated that they received two incurred cost audit reports and will begin the process of negotiating rates with the contractor. They also stated that they will continue to use DCAA because DOD has cognizance over many of its contractors. HHS officials stated that some of their components use DCAA for incurred cost audits, but others are using alternate options such as conducting the audit work internally or contracting out to private firms for audit support services.

Further, in April 2016, the Office of Management and Budget sent out a survey to federal agencies to gauge the effect of the DCAA prohibition and determine the agencies' audit needs. The survey determined that there was enough of a need for contract audit support services that, in August 2016, the Federal Aviation Administration—in coordination with the Office of Management and Budget—led a civilian agency working group to address this gap. Since then, the working group conducted market research to identify the extent to which civilian agencies relied on DCAA or private sector providers to perform financial audits on their behalf, the extent to which the private sector can address the need for contract audit support services, and potential contract approaches to meet the needs of civilian agencies. For example, the working group determined that federal agencies spent about \$100 million annually on contract audit support services, either through reimbursable work performed by DCAA or through contracts awarded to private accounting firms. The working group is working with the Office of Management and Budget and the General Services Administration on a contract solution

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<sup>25</sup>Blanket purchase agreements (BPAs) are intended to be a simplified method of fulfilling repetitive needs for supplies and services that, when issued to federal supply schedule vendors, also provide an opportunity to seek reduced pricing from vendors' schedule prices. Agencies may award BPAs to one vendor (known as a single award) or to more than one vendor (multiple award), and then issue individual orders to fulfill requirements for goods and services as they arise.

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that maximizes existing contracts already available across multiple agencies using the General Services Administration's Federal Supply Schedules program.<sup>26</sup> Further, the working group is preparing an ordering guide to assist agencies with placing contracts for contract audit related services. The guide, expected to be completed by August 2017, will also identify best practices to address concerns regarding the quality of audits.

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## DCAA Made Progress in Reducing Its Incurred Cost Audit Backlog, but Opportunities Exist for Improvement

DCAA made progress in reducing its inventory of incurred cost proposals awaiting audit by about half since fiscal year 2011 and has closed more than three-quarters of its oldest proposals—those submitted for years prior to fiscal year 2014. This reduction was due to several initiatives that DCAA implemented in recent years, such as risk-based sampling, conducting multi-year audits, and dedicating more staff resources to conduct incurred cost audits. DCAA did not, however, meet its goal of having 2 years of incurred cost proposals in its inventory by fiscal year 2016 and may not be able to meet its revised goal to do so by the end of fiscal year 2018. Further, our work identified two areas in which DCAA may be missing opportunities or currently lacks information to help identify additional ways to reduce its inventory. These areas include: (1) assessing actions for reducing the amount of time it takes for DCAA to begin an incurred cost audit and establishing related performance measures to assess its progress and (2) evaluating the use of multi-year auditing and establishing related performance measures.

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## DCAA Reduced Total Inventory, Including Its Backlog of Incurred Cost Proposals Awaiting Audit

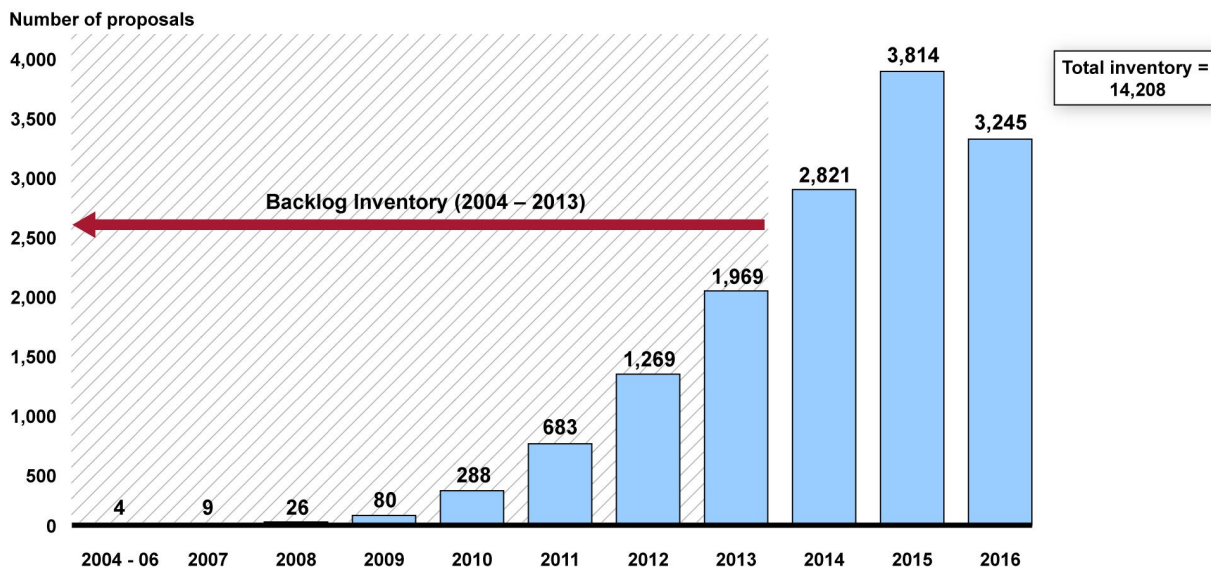
DCAA has reduced its overall inventory of incurred cost proposals awaiting audit from about 31,000 in fiscal year 2011 to about 14,000 as of the end of fiscal year 2016. Over that same time period, DCAA reduced what it characterizes as its backlog of old incurred cost proposals—those proposals submitted for fiscal year 2013 and prior—from 21,000 to below

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<sup>26</sup>The Federal Supply Schedules program provides federal agencies a simplified method of purchasing commercial products and services at prices associated with volume buying.

5,000.<sup>27</sup> DCAA did not, however, meet its original goal of having a 2-year inventory of audit proposals—eliminating its backlog of proposals older than 2 years—by fiscal year 2016 and acknowledged that meeting its revised goal to do so by the end fiscal year 2018 will be challenging. DCAA policy officials stated that they were unable to meet the goal of eliminating the backlog due to resource constraints, including workforce challenges, such as hiring freezes. Overall, as of the end of fiscal year 2016, DCAA’s total inventory included 14,208 incurred cost proposals, representing approximately \$825 billion in auditable dollar value (ADV) (see figure 3).

**Figure 3: Number of Contractor Proposals in the Defense Contract Audit Agency’s (DCAA) Inventory as of September 30, 2016**



Source: GAO analysis of Defense Contract Audit Agency data. | GAO-17-738

Note: The total inventory count of 14,208 includes proposals that DCAA is working on under a reimbursable basis. According to DCAA officials, the inventory also includes proposals for 2004, 2005, and one from 2006 from one contractor, which are currently tied up in an investigation, precluding DCAA from completing the audits on these proposals.

<sup>27</sup>DCAA defines its backlog as incurred proposals that have not yet been audited and that cover costs incurred prior to the past 2 fiscal years. At the time of our review, that definition included all proposals submitted for costs incurred for 2013 and prior. As of October 1, 2017, the backlog will include any proposals for 2014 and prior. DCAA tracks proposals based upon the year for which it is for, not when the contractor submitted it. For example, if a contractor submitted an incurred cost proposal for 2012 on September 30, 2015, the proposal is tracked as a 2012 proposal.

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DCAA attributes its progress in reducing its total inventory as well as its backlog of incurred cost proposals awaiting audits to various efforts, such as management attention in prioritizing incurred cost audits, as well as two specific initiatives—the implementation of a risk-based approach to identify proposals for audit and multi-year audits, in which multiple proposals are done under a single audit.

### **Risk-Based Sampling**

DCAA has reduced its inventory primarily through the use of a risk-based approach to conducting audits. Under this approach, DCAA focused its resources on conducting audits of proposals that it deemed high-risk or exceeded \$250 million in ADV. According to DCAA policy officials, DCAA auditors are supposed to make the risk assessment concurrently when determining that a proposal is adequate. Factors that DCAA considers when conducting a risk assessment include whether a specific risk was identified by an external source—such as a contracting officer—or the audit team has identified a specific risk that has a material impact to the proposal being assessed, business system deficiencies, and prior audit experience with the contractor, among others. DCAA officials stated that DCAA audits all proposals that are deemed high risk regardless of ADV. As of the end of fiscal year 2016, DCAA's data indicates contractors had submitted 9,309 incurred cost proposals that were either deemed adequate by DCAA or were awaiting an adequacy review. DCAA reported it had made a risk assessment on 8,426, or about 91 percent, of those proposals. DCAA policy officials stated that several factors contributed to the gaps on the status of proposals, such as instances where audits on proposals for earlier years for a contractor are ongoing and DCAA would need to consider the results of those audits when assessing risk for proposals for later years.

For incurred cost proposals that were deemed low-risk or were \$250 million or below in ADV, DCAA would audit a certain percentage of those proposals, with the percentages varying by different strata. As a result, DCAA conducts far fewer audits on low-risk, lower-dollar value proposals than it did prior to initiating the risk-based approach in 2012. For low-risk and lower-dollar value proposals that were not sampled, DCAA issues a low-risk memorandum that recommends the contracting officers use his or her authority to determine the contractor's final indirect cost rates and proceed with closing the contract. Unless they are assessed to be high-risk, DCAA will close the majority of these proposals with a low-risk memorandum. Since the risk-based initiative was implemented in 2012, DCAA issued a total of 18,292 low-risk

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memorandums to close out proposals, compared to a total of 9,641 incurred cost audit reports.

In developing the risk-based approach, DCAA assessed the costs associated with performing audits at different ADV against the savings associated with identifying unallowable or questioned costs. DCAA determined that it had a higher return on investment for higher value ADV proposals and that the return on investment was negative for audits conducted on lower-dollar proposals. For example, DCAA reported that even under its risk-based approach, it conducted 767 audits on incurred cost proposals with ADVs of \$1 million or less from fiscal years 2014 through 2016, but expended approximately \$18 million more in staff resources than the government received by identifying unallowable or questioned costs. DCAA policy officials stated they regularly assess results and, if appropriate, revise the sampling percentages.

### **Multi-year Audits**

DCAA policy officials also noted that the use of multi-year auditing—through which it combines audits of two or more incurred cost proposals into a single audit—has helped reduce the inventory. According to DCAA’s data, multi-year auditing reduced the average number of hours to conduct an audit by 40 percent over conducting separate single-year audits. DCAA, however, does not actively track at the agency level how many proposals have been closed or are planned to be closed using this process. DCAA policy officials stated that DCAA’s management information system does not have a specific field to collect information on open proposals that are planned to be closed using multi-year audits. Instead, DCAA policy officials stated that they can determine the number of proposals closed through multi-year auditing once the audit reports have been issued. DCAA reported that it used multi-year audits to close 1,232 and 1,536 incurred cost proposals, in fiscal years 2015 and 2016, respectively, which constituted about 13 percent and 19 percent, respectively, of the total number of incurred cost proposals closed in those years.

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### **DCAA Has Not Developed Certain Performance Measures for Its Incurred Cost Proposals**

While DCAA has made progress in reducing its inventory of incurred cost proposals awaiting audit, our work identified two areas in which DCAA may be missing opportunities or lacking information to help identify

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additional ways to reduce its inventory. These areas include: (1) assessing actions for reducing the amount of time it takes for DCAA to begin audit work and establishing related performance measures to monitor its progress and (2) evaluating the use of multi-year auditing and establishing related performance measures. Federal standards for internal control call for the establishment of clear, consistent objectives and the identification and analysis of what measures will be used to determine if an agency is achieving those objectives.<sup>28</sup>

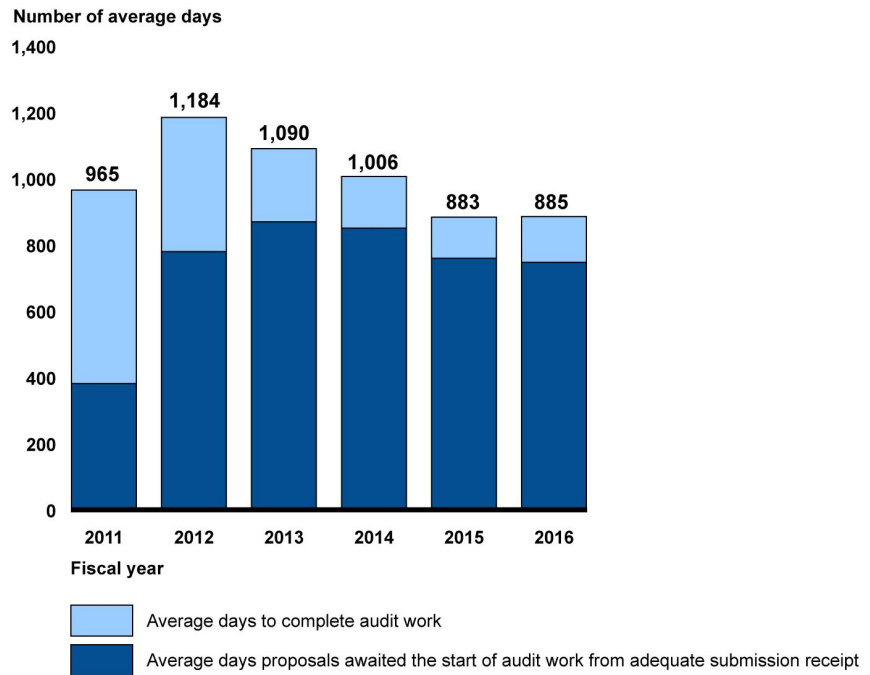
DCAA's data for fiscal year 2016 indicate that once a contractor submits an adequate incurred cost proposal, it took DCAA on average 885 days—or nearly 2 and a half years—before DCAA completed the incurred cost proposal audit. Further, our analysis found that DCAA's backlog of contractor proposals submitted for 2013 and prior years includes 51 adequate proposals that have \$1 billion or more in ADV submitted by at least 15 of DOD's largest contractors for which audits have not been completed. The number of days from the date these 51 proposals were determined adequate ranged from 78 to 2,206 days at the end of fiscal year 2016, meaning that a contractor submitted an adequate cost proposal more than 6 years ago but DCAA has not yet completed the audit. According to DCAA policy officials, staff availability is the primary factor for the delay before starting audit work. For example, proposals closed in fiscal year 2016 waited in DCAA's queue an average of 747 days before the start of audit work. From the time that DCAA initiated the audit—which it defines as the date DCAA holds an entrance conference with the contractors—it took DCAA about 138 days on average to complete the audit in fiscal year 2016.<sup>29</sup> For the average days that DCAA took to complete incurred cost audits from fiscal years 2011 through 2016, see figure 4.

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<sup>28</sup>[GAO-14-704G](#).

<sup>29</sup>The average elapsed days until completion includes proposals that are closed through the issuance of low-risk memorandums for those low-risk incurred cost proposals not selected for audit. According to DCAA policy officials, the average time to issue a low-risk memorandum was about 72 days in fiscal year 2016.

**Figure 4: Average Number of Days for the Defense Contract Audit Agency to Complete Incurred Cost Audits**



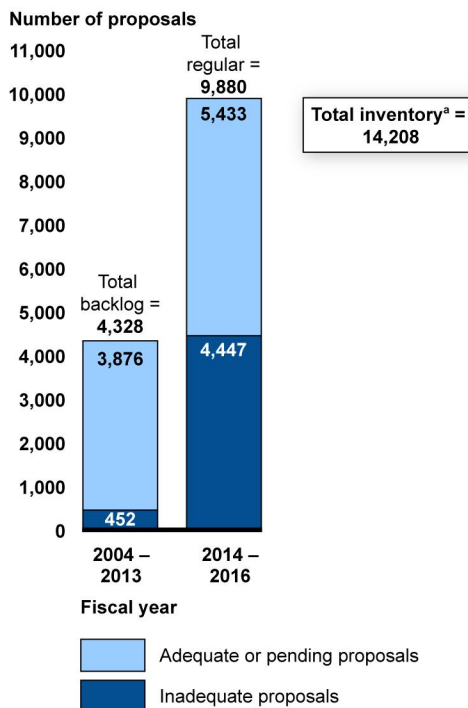
Source: GAO analysis of Defense Contract Audit Agency data. | GAO-17-738

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DCAA policy officials attributed the delay in initiating an audit once adequacy is determined to several factors, including the lack of staff, and when adequate proposals are submitted—the majority of which are received in June each year, which leaves little time to take action before the end of the fiscal year. Further, DCAA officials noted that, historically, DCAA used a “6-24-6” month framework for conducting incurred cost audits. DCAA officials noted that the FAR provides contractors 6 months to submit an incurred cost proposal, and, if DCAA is able to complete its audit of that proposal within 24 months, contracting officers will have 6 months to close out flexibly-priced contracts. Delays in receiving an adequate proposal will affect contracting officers’ ability to close out the contracts in a timely manner. Even though the 6-24-6 framework is not being met in practice, DCAA has not established specific goals for initiating audits, nor assessed whether the 6-24-6 framework under which it currently operates should be revised to take into account the realities of the time frames for contractors to submit adequate proposals or DCAA’s own staffing shortages. Assessing and implementing options to reduce the amount of time DCAA takes to begin its incurred cost audit work and establishing performance measures could help DCAA further reduce its inventory.

Complicating DCAA’s ability to plan and initiate audit work are proposals submitted by contractors that are determined to be inadequate. While DCAA has started, or could start audit work on almost 90 percent of the backlog of 4,328 incurred cost proposals which were considered adequate, more than 10 percent—or 452—proposals were still considered inadequate. For example, we identified 10 proposals of \$1 billion or more in ADV submitted for fiscal years 2011 through 2013 by major defense contractors that were still considered inadequate as of September 2016. These 10 proposals collectively amounted to about \$36 billion in ADV, or about 9 percent of DCAA’s total amount of ADV in its backlog. For fiscal years 2014 through 2016, about 45 percent of the incurred cost proposals submitted by contractors were considered inadequate. Figure 5 depicts the extent to which proposals associated with DCAA’s incurred cost inventory were considered adequate, which includes proposals pending an adequacy review, and proposals that were considered inadequate.

**Figure 5: Number of Adequate Proposals in the Defense Contract Audit Agency's (DCAA) Inventory as of Fiscal Year 2016**



Source: GAO analysis of Defense Contract Audit Agency data. | GAO-17-738

<sup>a</sup>The total inventory includes the proposals considered inadequate—those that DCAA has not received from contractors, the contractors have withdrawn the proposals, or DCAA has returned the proposals to the contractors.

DCAA officials acknowledged that they do not currently have insight into the reasons why DCAA determined that a contractor's proposal was inadequate, the number of times that a contractor submits revised proposals until it is deemed adequate, or the length of time it takes to receive an adequate proposal, but they noted they recently began an initiative to do so. Additionally, DCAA recently began to study the feasibility of developing a web-based submission portal for incurred cost proposals that could allow contractors the option to submit their proposals with real time visibility and guidance on common issues. This could lessen the number of times proposals are returned by DCAA as inadequate since contractors could identify potential issues prior to initially submitting proposals.

Additionally, DCAA does not actively track how many proposals are planned to be closed using multi-year audits. These audits accounted for 19 percent of the total number of incurred cost proposals closed in fiscal

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year 2016, and, according to DCAA policy officials, DCAA would like to continue the use of multi-year audits to gain work efficiencies by combining proposals under one audit. DCAA has not, however, fully evaluated how the process could be improved nor established related performance measures, such as the number of proposals closed, ADV examined, the timeliness of the audits, or its impact on contractors. Federal standards for internal control call for the establishment of clear, consistent objectives and the identification and analysis of what measures will be used to determine if an agency is achieving those objectives.<sup>30</sup> Industry representatives noted that multi-year audits take more effort on their part to support—especially for older proposals—and do not enable them to correct deficiencies in a timely fashion. DCAA is aware of these concerns and has sought contractor input about the efficacy and usefulness of multi-year audits, but has not done a comprehensive assessment, including how, if at all, the use of multi-year audits affect industry or determined how the process could be improved. As a result, it would be difficult for DCAA to assess if there are areas to multi-year auditing where additional efficiencies could be gained.

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## Conclusions

We found that closing out contracts is not the highest priority for contracting officers that are charged with awarding and administering contracts for products and services to meet mission needs. Yet this is a critical step to ensure the government receives the goods and services it purchases at the agreed upon price and, if done in a timely manner, provides opportunities to utilize unspent funds for other needs. Most of the agencies we reviewed delegated responsibility for closing out contracts to their components; however, none of the five agencies and only one of the components we reviewed had the critical elements that would assist them in overseeing their efforts to more effectively manage their respective contract closeout backlog. Having centralized information on the number and type of contracts that need to be closed out and where the contracts are in the closeout process could help management address the causes as to why contracts remain open in order to reduce the contract closeout backlog. While agencies may tailor their approaches to their specific needs and organizational structures, federal internal control standards require that agency management use quality

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<sup>30</sup>[GAO-14-704G](#).

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information to make informed decisions and evaluate the entity's performance in achieving key objectives and addressing risks—especially if the risks and challenges are similar across the agency.<sup>31</sup>

DCAA's investment of significant management attention and resources, as well as its use of risk-based approaches to conducting audits, has enabled DCAA to significantly reduce both its overall inventory and its backlog of older incurred cost proposals. Doing so should help contracting officers close more of their outstanding flexibly-priced contracts, enable DCAA to focus more of its resources on other audit responsibilities, and reduce some of the burden on industry. Despite this progress, DCAA has 14,208 incurred cost proposals in its inventory, representing approximately \$825 billion in ADV as of fiscal year 2016; hence, DCAA cannot afford to miss opportunities to further improve its incurred cost audit processes and timeliness. In this regard, DCAA has not assessed options and has not established performance measures for reducing the length of time to begin audit work on incurred cost proposals; the primary reason for the delay is due to the availability of DCAA staff to begin the audit work. Further, DCAA has not fully assessed or established performance measures on the use of multi-year audits, which it hopes to expand to help further reduce its inventory. Without such information, DCAA will be missing opportunities to assess options for further reducing its inventory of incurred cost proposals.

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## Recommendations for Executive Action

To enhance management attention to closing out contracts, we are making the following seven recommendations, one to each of the five agencies in our review and two to DCAA to manage its incurred cost inventory.

- The Secretary of Defense should develop a means for department-wide oversight into components' progress in meeting their goals on closing contracts and the status of contracts eligible for closeout. (Recommendation 1)
- The Secretary of Health and Human Services should develop a means for department-wide oversight into components' progress in

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<sup>31</sup> [GAO-14-704G](#).

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meeting their goals on closing contracts and the status of contracts eligible for closeout. (Recommendation 2)

- The Secretary of Homeland Security should develop a means, either at the agency or the component level, to track where the contracts are in the closeout process, and establish goals and performance measures for closing contracts. (Recommendation 3)
- The Attorney General should direct the Senior Procurement Executive to ensure the development of a means to track data on the number and type of contracts eligible for closeout and where the contracts are in the closeout process, as well as a means to assess—at the agency or component level—progress by establishing goals and performance measures for closing contracts. (Recommendation 4)
- The Secretary of State should develop a means at the agency level to track data on the entirety of the number and type of contracts eligible for closeout, where the contracts are in the closeout process, and establish goals and performance measures for closing contracts. (Recommendation 5)
- The Director, DCAA should assess and implement options for reducing the length of time to begin incurred cost audit work and establish related performance measures. (Recommendation 6)
- The Director, DCAA should comprehensively assess the use and effect of multi-year audits on both DCAA and contractors and establish related performance measures. (Recommendation 7)

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## Agency Comments and Our Evaluation

We provided a draft of this report to DOD, DHS, State, HHS, and DOJ for review and comment. With the exception of DHS, the agencies concurred with our recommendations. DOD, DHS, and State provided written comments, which are reprinted in appendixes I-III, respectively, and summarized below. In comments provided in emails from the respective audit liaisons, DOJ and HHS concurred with the recommendations. DOD, DHS, and DOJ also provided technical comments, which we incorporated as appropriate.

DOD concurred with our recommendation to develop a means for department-wide oversight into components progress in meeting their goals on closing contracts and the status of contracts eligible for closeout. Additionally, DOD concurred with our recommendations that the Director, DCAA, assess and implement options for reducing the length of time to

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begin incurred cost audit work and to comprehensively assess the use and effect of multi-year audits. DOD also agreed that the length of time to start an incurred cost audit should be minimized to the maximum extent practicable. DOD noted that in addition to the initiatives identified in our report, DCAA will continue to assess options to improve timeliness and implement actions to do so. Further, DOD agreed to conduct a more comprehensive analysis regarding the use and effect of multi-year audits on the contractors being audited as well as customers relying on the audit reports. DOD plans to complete these actions by March 31, 2018. Our draft report also included a recommendation that DCAA develop a means to centrally track risk assessments determinations. In responding to our draft report, DCAA provided additional information on how risk determinations were tracked and provided supporting data. We verified that information and, as a result, removed the recommendation and incorporated the data into the report as appropriate.

DHS did not concur with our recommendation to develop a means to track where contracts are in the closeout process and establish related performance goals and measures. DHS agreed that contract closeout was a critical step in the procurement process, but noted that contract closeout activities are limited to available resources. DHS stated that the agency does not have a tool to track where contracts are in the closeout process and that obtaining such a tool would be resource-intensive. Further, DHS noted that having such a tool would not provide DHS with an effective way to remove bottlenecks from the closeout process. DHS noted, however, that it is committed to improving the closeout process and intends to establish a working group to assess current close out metrics and related performance measures. Additionally, the working group will assess the list of contracts eligible for closeout, monitor the progress of reducing the backlog and determine whether existing tools are available for obtaining information on the closeout process. The working group will also recommend improvements based on the availability of resources for closeout actions by November 30, 2018. While we did not call on DHS to obtain a new tracking tool, we believe that the planned efforts of the working group could meet the intent of our recommendation.

State agreed with our recommendation to develop a means to track where contracts are in the closeout process and establish related performance goals and measures. State noted that it anticipates developing goals and performance measures by December 2019.

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We are sending copies of this report to the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; the Director, Defense Contract Audit Agency; the Director, Defense Contract Management Agency; the Director, Defense Logistics Agency; the Secretaries of Health and Human Services, Homeland Security, and State; the Attorney General; appropriate congressional committees; and other interested parties. This report will also be available at no charge on GAO's website at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4841 or by e-mail at [dinapolit@gao.gov](mailto:dinapolit@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix V.

A handwritten signature in black ink, appearing to read "Timothy J. DiNapoli". The signature is fluid and cursive, with the first name "Timothy" and last name "DiNapoli" clearly distinguishable.

Timothy J. DiNapoli  
Director, Acquisition and Sourcing Management

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*List of Addressees*

The Honorable John McCain  
Chairman

The Honorable Jack Reed  
Ranking Member  
Committee on Armed Services  
United States Senate

The Honorable Claire McCaskill  
Ranking Member  
Committee on Homeland Security and Governmental Affairs  
United States Senate

The Honorable Thad Cochran  
Chairman

The Honorable Richard Durbin  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
United States Senate

The Honorable Thomas R. Carper  
Ranking Member  
Permanent Subcommittee on Investigations  
Committee on Homeland Security and Governmental Affairs  
United States Senate

The Honorable Mac Thornberry  
Chairman

The Honorable Adam Smith  
Ranking Member  
Committee on Armed Services  
House of Representatives

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The Honorable Kay Granger  
Chairwoman  
The Honorable Pete Visclosky  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
House of Representatives

## Appendix I: Comments from the Department of Defense



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

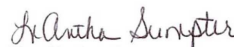
September 18, 2017

Mr. Timothy J. DiNapoli  
Director, Acquisition and Sourcing Management  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, DC 20548

Dear Mr. DiNapoli:

This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report, GAO-17-738, "FEDERAL CONTRACTING: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog," dated August 10, 2017 (GAO Code 100964). Detailed comments on the report recommendations are enclosed.

Sincerely,

*for*   
Shay D. Assad  
Director, Defense Pricing

Enclosure:  
As stated

**GAO Draft Report Dated August 10, 2017  
GAO-17-738 (GAO CODE 100964)**

**“FEDERAL CONTRACTING: ADDITIONAL MANAGEMENT ATTENTION AND  
ACTION NEEDED TO CLOSE CONTRACTS AND REDUCE AUDIT BACKLOG”**

**DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATION**

**RECOMMENDATION 1:** The GAO recommends that the Secretary of Defense should develop a means for department-wide oversight into components' progress in meeting their goals on closing contracts and the status of contracts eligible for closeout.

**DoD RESPONSE:** Concur.

**RECOMMENDATION 2:** The GAO recommends that the Director, DCAA should assess and implement options for reducing the length of time to begin incurred cost audit work and establish related performance measures.

**DoD RESPONSE:** Concur. The Department agrees that the length of time to start an audit of an incurred cost proposal should be minimized to the maximum extent practicable. Over the previous years, with the incurred cost backlog, the period of time before the start of the audit was longer than it should be as DCAA continued to work the incurred cost backlog with the limited resources it had available. As discussed in the GAO report, DCAA has made progress in reducing its inventory of incurred cost proposals based upon initiatives put in place including low-risk sampling and multi-year audits. As DCAA becomes more current on the performance of their incurred cost audits, the period of time will continue to decrease, and the audits will be more current and timely. Additionally, as discussed in the GAO report, DCAA has recently initiated a tool that will allow the Agency to begin tracking the length of time it takes to get an adequate proposal and the reasons for returning proposals as inadequate. DCAA is also in the early development stages for implementing a web-based submission portal that contractors could use to submit their proposals that will provide clear expectations for what makes a proposal adequate. We believe that improving the process for contractors to submit proposals and identifying common inadequacies to address with the contractors will greatly improve the timeframe for obtaining adequate proposals from the contractor, thus reducing the amount of time spent by both the contractor and DCAA. The Department will continue to assess additional options for reducing the length of time to begin an incurred cost audit. This assessment will be complete by March 31, 2018. Upon completion of this assessment the Department will implement any actions deemed necessary and establish appropriate related performance measures.

**RECOMMENDATION 3:** The GAO recommends that the Director, DCAA should comprehensively assess the use and effect of multi-year audits on both DCAA and contractors and establish related performance measures.

**DoD RESPONSE:** Concur. Although DCAA has done its own assessment of the efficiencies gained through the use of multi-year audits, the Department agrees that a comprehensive assessment should be done to include the use and effect of multi-year audits on the contractors being audited, and the customers that rely upon the audit reports, as discussed by the Director, DCAA at her recent testimony. This comprehensive assessment will be complete by March 31, 2018. Upon completion of this assessment, the Department will establish appropriate related performance measures.

## Appendix II: Comments from the Department of Homeland Security

U.S. Department of Homeland Security  
Washington, DC 20528



**Homeland  
Security**

September 7, 2017

Tim DiNapoli  
Director, Acquisition and Sourcing Management  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Re: Management's Response to Draft Report GAO-17-738, "FEDERAL CONTRACTING:  
Additional Management and Action Needed to Close Contracts and Reduce Audit  
Backlog"

Dear Mr. DiNapoli:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) appreciates the U.S. Government Accountability Office's (GAO) work in planning and conducting its review and issuing this report.

The Department is pleased to note GAO's recognition of DHS's management efforts to reduce the number of contracts overdue for closeout. Specifically, GAO cited the March 2016 joint effort by the Offices of the Chief Procurement Officer and the Chief Financial Officer to identify the extent of the Department's contract closeout backlog. GAO highlights that DHS's management made a commitment to address contract closeout challenges, gained insight into the extent of the Department's contract closeout backlog, and has initiatives underway to address a portion of the backlog. The report mentions DHS's ongoing efforts to address low-risk, firm-fixed-priced contracts as an illustration of one of those initiatives. DHS remains committed to limiting the government's exposure to financial risk by ensuring contracts are closed in a timely manner.

The draft report contained one recommendation for DHS, with which the Department non concurs. Please see attached for our detailed response to the recommendation.

Again, thank you for the opportunity to review and comment on this draft report. Technical comments were previously provided under separate cover. Please feel free to contact me if you have any questions. We look forward to working with you again in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim H. Crumacker".

JIM H. CRUMPACKER, CIA, CFE  
Director  
Departmental GAO-OIG Liaison Office

Attachment

**Attachment: DHS Management Response to Recommendation  
Contained in GAO-17-738**

GAO recommended that the Secretary of Homeland Security:

**Recommendation 1:** Develop a means, either at the agency or the Component level, to track where contracts are in the closeout process, and establish goals and performance measures for closing contracts.

**Response:** Non Concur. The Department does not concur with developing a means to track where contracts are in the closeout process. While the Department agrees that contract closeout is a critical step in the procurement process, contract close out activities are limited to available resources. The Department does not have a tool that tracks where a contract is in the closeout process. Obtaining such a tool would require DHS to reduce its contract close out activities to fund a tool that could track status of non-linear manual tasks. Also, the Department is unable to develop a means, either at the agency or Component level, to track where contracts are in the closeout process. Contract closeout is a manual paper and research process that requires customization for each action and constant manual data entry. Both of these tasks are labor-and time-intensive and impede DHS's ability to close contracts in a timely manner. Moreover, even if such a means were available, it would not provide DHS with an effective way to remove bottlenecks from the closeout process.

Notwithstanding this, the Department remains committed to improving the closeout process, and to that end gathers information on the number of contracts that have been closed and are eligible for closeout. This information is reported to the Office of the Chief Procurement Officer (OCPO), and the Chief Procurement Officer uses this information to monitor each contracting activity's effort to reduce its backlog of open, but physically complete, contracts. The Department believes that it is more effective to continue to prudently close contracts, as efficiently as possible, based on risk, rather than to divert resources to augment our tracking system.

To identify challenges in the closeout process, and to find areas of improvement, OCPO will establish a working group, comprised of representatives of each contracting activity and each Component Office of the Chief Financial Officer. This working group will assess the current close out metrics and performance measures and recommend improvements. Additionally, this working group will assess the list of open but physically complete contracts, prioritize contracts for closeout, and monitor progress on reducing the overall backlog. The working group will also assess whether there are any feasible tools available, within DHS's fiscal constraints, that could provide valuable information on the contract close out process. Recommendations from the working group will be used to improve the closeout process. Estimated Completion Date (ECD): November 30, 2018.

In addition, OCPO will continue to monitor the unique contracting activity targets for contract close out in order to ensure progress on reducing the backlog of over aged open but physically complete contracts. The targets will be based on the resources available to the contracting activity and the complexity of the contracts awaiting closure. ECD: November 30, 2018

## Appendix III: Comments from the Department of State



Charles M. Johnson, Jr.  
Managing Director  
International Affairs and Trade  
Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548-0001

United States Department of State

Comptroller

Washington, DC 20520

SEP - 5 2017

Dear Mr. Johnson:

We appreciate the opportunity to review your draft report, "FEDERAL CONTRACTING: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog" GAO Job Code 100964.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Raymond Bouford, Director, Office of Acquisitions Management, Bureau of Administration at (703) 875-5429.

Sincerely,

A handwritten signature in dark ink, appearing to read "Chris H. Flaggs".

Christopher H. Flaggs

Enclosure:  
As stated

cc: GAO – Timothy DiNapoli  
A – Harry Mahar (Acting)  
State/OIG - Norman Brown

**Department of State Comments on GAO Draft Report**

**FEDERAL CONTRACTING: Additional Management Attention and Action  
Needed to Close Contracts and Reduce Audit Backlog**  
(GAO-17-738, GAO Code 100964)

Thank you for the opportunity to comment on the GAO draft report, entitled  
*"Federal Contracting: Additional Management Attention and Action Needed to  
Close Contracts and Reduce Audit Backlog."*

**Recommendation:** We are recommending that the Secretary of State develop  
a means at the agency level to track data on the entirety of the number and  
type of contracts eligible for closeout, where the contracts are in the closeout  
process, and establish goals and performance measures for closing contracts.

Department of State agrees with the recommendation. Based on lessons learned  
from previous audit findings, the Department redesigned the contracts writing  
system to require more accurate ultimate end dates to better reflect the base and all  
option years for new awards. Additionally the Office of Acquisitions Management  
has mandated an electronic filing system that will enable the Department to better  
track contracts eligible for close out and prompt attention by the Contracting  
Officer when required actions are necessary. In the short term, we will prioritize  
close out actions based on dollar value to coincide with limited resources to  
accomplish necessary actions. Early de-obligation of unneeded funding will be the  
top priority.

An enhancement priority for the electronic filing system is to develop a mechanism  
to track contracts in the close out life cycle. Goals and performance measures will  
be developed once a baseline is established in the automated system. We  
anticipate completion by December 31, 2019 but all system development and  
performance measurement is contingent upon budget and staffing limitations.

## Appendix IV: Defense Contract Audit Agency's (DCAA) Average Inventory Calculation

Congress enacted a provision in the National Defense Authorization Act (NDAA) for Fiscal Year 2016 which prohibited the Defense Contract Audit Agency (DCAA) from conducting audits for non-defense agencies unless the Secretary of Defense certified that DCAA's backlog of incurred cost audits was less than 18 months of incurred cost inventory.<sup>1</sup> The law defined DCAA's incurred cost inventory as the level of contractor incurred cost proposals from prior fiscal years that were currently being audited by DCAA. In September 2016, the Under Secretary of Defense (Comptroller) certified to Congress that DCAA had reduced its incurred cost proposal inventory below the required 18 month threshold to an average of 17.6 months.

To support this determination, DCAA used its total inventory of incurred cost proposals that were in its inventory as of August 2016. DCAA made several adjustments to this total inventory to remove those incurred cost proposals for which it could not conduct an audit (i.e. were determined to be inadequate) and removed the number of reimbursable proposals (since these proposals are primarily for non-defense agencies which DCAA was prohibited from doing by the NDAA for Fiscal Year 2016) and direct-cost only work.<sup>2</sup> Using the revised number, DCAA then took the number of elapsed days since the contractor submitted an adequate incurred cost proposal and divided by 30 days to approximate the number of elapsed months. The number of elapsed months was then averaged across the inventory to arrive at their total inventory calculation.

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<sup>1</sup>The National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 893 (2015).

<sup>2</sup>Incurred cost proposals include both direct and indirect costs. The direct-cost only category is a subset of the contractor proposals that has been separated from the indirect costs—already included in the inventory. DCAA removes from the count direct-cost only proposals to avoid double-counting proposals.

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## Appendix V: GAO Contact and Staff Acknowledgments

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### GAO Contact

Timothy J. DiNapoli, (202) 512-4841 or [dinapolit@gao.gov](mailto:dinapolit@gao.gov)

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### Staff Acknowledgments

In addition to the contact named above, Bruce Thomas (Assistant Director), Anh Nguyen (Analyst-in-Charge), Peter Anderson, Giny Cheong, William Cordrey, Lorraine Ettaro, Kurt Gurka, Julia Kennon, Elisha Matvay, and Roxanna Sun made major contributions to this report.

## Appendix VI: Accessible Data

### Data Tables

**Data Table for Highlights figure, Average Number of Days for the Defense Contract Audit Agency to Complete Incurred Cost Audits**

	Average days proposals awaited for the start of audit work	Average days to complete incurred cost audit from entrance submission receipt to report issuance	Average days to complete incurred cost audit from adequate submission receipt to report issuance
2011	381	584	965
2012	779	406	1184
2013	869	221	1090
2014	850	156	1006
2015	759	124	883
2016	747	138	885

#### Data for Figure 1: Contract Closeout Process

- 1) Contract is physically complete/ goods and services received
- 2) Contracting Officer performs pre-closeout administrative tasks /a (if contract is firm-fixed price, process continues to 3. If contract is flexibly priced, process goes to 2a)
  - a) Indirect cost rates settled with auditor recommendations
  - b) Indirect cost rates settled with auditor recommendations
  - c) Final invoice submitted and reviewed
- 3) Payment differences reconciled and excess funds deobligated
- 4) Contract closed when contracting officer signs contract completion statement

#### Data for Figure 2: Defense Contract Audit Agency's Incurred Cost Audit Process

- 1) Contractor submits incurred cost Proposal including all flexibly-priced contracts for a fiscal year
- 2) DCAA evaluates incurred cost proposal for adequacy

- a) Inadequate proposal (if inadequate, returns to phase 1)
- 3) Adequate Proposal
- 4) DCAA selects certain proposals for audit, identifies questioned costs and recommends rates.
- Selected steps in the audit process, including but not limited to:
- Evaluate labor costs
  - Assess internal controls
  - Physical observations
  - Transactions testing on materials and services
- 5) Contracting officer or auditor settles indirect cost rates with contractor for fiscal year
- 6) Incurred cost audit process is repeated for all fiscal years (returns to phase 1)

**Data Table for Figure 3: Number of Contractor Proposals in the Defense Contract Audit Agency's (DCAA) Inventory as of September 30, 2016**

Year	Number of proposals
2004 to 2006	4
2007	9
2008	26
2009	80
2010	288
2011	683
2012	1269
2013	1969
2014	2821
2015	3814
2016	3245

**Data Table for Figure 4: Average Number of Days for the Defense Contract Audit Agency to Complete Incurred Cost Audits**

Year	Average days proposals awaited for the start of audit work	Average days to complete incurred cost audit from entrance submission receipt to report issuance	Average days to complete incurred cost audit from adequate submission receipt to report issuance
2011	381	584	965
2012	779	406	1184
2013	869	221	1090
2014	850	156	1006
2015	759	124	883
2016	747	138	885

**Data Table for Figure 5: Number of Adequate Proposals in the Defense Contract Audit Agency's (DCAA) Inventory as of Fiscal Year 2016**

Time Period	Inadequate proposals	Adequate or pending proposals
Fiscal year 2004 –2013	453	3,876
Fiscal year 2014 –2016	4,447	5,433
Total	backlog = 4,328	regular = 9,880

## Agency Comment Letters

### Text of Appendix I: Comments from the Department of Defense

#### Page 1

Mr. Timothy J. DiNapoli

Director, Acquisition and Sourcing Management

U.S. Government Accountability Office 441 G Street, N.W.

Washington, DC 20548 Dear Mr. DiNapoli :

September 18, 2017

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This is the Department of Defense (DoD) response to the Government Accountability

Office (GAO) Draft Report , GAO- 17-7 38, " FEDE RAL CONTRACTING: Additional Management Attention and Action needed to Close Contracts and Reduce Audit Backlog,"

dated August 10, 2017 (GAO Code 100964). Detailed comments on the report recommendations are enclosed.

Sincere ly,

Shay D. Assad

Director , Defense Pricing

Enclosure:

As stated

Page 2

DEPARTMENT OF DEFENSE COMMENTS TO THE GAO  
RECOMMENDATION

**RECOMMENDATION 1:**

The GAO recommends that the Secretary of Defense should develop a means for department-wide oversight into components' progress in meeting their goals on closing contracts and the status of contracts eligible for closeout.

**DoD RESPONSE: Concur.**

**RECOMMENDATION 2:**

The GAO recommends that the Director, DCAA should assess and implement options for reducing the length of time to begin incurred cost audit work and establish related performance measures.

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**DoD RESPONSE: Concur.**

The Department agrees that the length of time to start an audit of an incurred cost proposal should be minimized to the maximum extent practicable. Over the previous years, with the incurred cost backlog, the period of time before the start of the audit was longer than it should be as DCAA continued to work the incurred cost backlog with the limited resources it had available. As discussed in the GAO report, DCAA has made progress in reducing its inventory of incurred cost proposals based upon initiatives put in place including low-risk sampling and multi-year audits. As DCAA becomes more current on the performance of their incurred cost audits, the period of time will continue to decrease, and the audits will be more current and timely. Additionally, as discussed in the GAO report, DCAA has recently initiated a tool that will allow the Agency to begin tracking the length of time it takes to get an adequate proposal and the reasons for returning proposals as inadequate. DCAA is also in the early development stages for implementing a web-based submission portal that contractors could use to submit their proposals that will provide clear expectations for what makes a proposal adequate. We believe that improving the process for contractors to submit proposals and identifying common inadequacies to address with the contractors will greatly improve the timeframe for obtaining adequate proposals from the contractor, thus reducing the amount of time spent by both the contractor and DCAA. The Department will continue to assess additional options for reducing the length of time to begin an incurred cost audit. This assessment will be complete by March 31, 2018. Upon completion of this assessment the Department will implement any actions deemed necessary and establish appropriate related performance measures.

Page 3

**RECOMMENDATION 3:**

The GAO recommends that the Director, DCAA should comprehensively assess the use and effect of multi-year audits on both DCAA and contractors and establish related performance measures.

**DoD RESPONSE: Concur.**

Although DCAA has done its own assessment of the efficiencies gained through the use of multi-year audits, the Department agrees that a comprehensive assessment should be done to include the use and effect of multi-year audits on the contractors being audited, and the customers

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that rely upon the audit reports, as discussed by the Director, DCAA at her recent testimony. This comprehensive assessment will be complete by March 31, 2018. Upon completion of this assessment, the Department will establish appropriate related performance measures.

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## Text of Appendix II: Comments from the Department of Homeland Security

### Page 1

September 7, 2017

Tim DiNapoli

Director, Acquisition and Sourcing Management

U.S. Government Accountability Office 441 G Street, NW

Washington, DC 20548

Re: Management's Response to Draft Report GAO-17-738, "FEDERAL CONTRACTING: Additional Management and Action Needed to Close Contracts and Reduce Audit Backlog"

Dear Mr. DiNapoli:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) appreciates the U.S. Government Accountability Office's (GAO) work in planning and conducting its review and issuing this report.

The Department is pleased to note GAO's recognition of DHS's management efforts to reduce the number of contracts overdue for closeout. Specifically, GAO cited the March 2016 joint effort by the Offices of the Chief Procurement Officer and the Chief Financial Officer to identify the extent of the Department's contract closeout backlog. GAO highlights that DHS's management made a commitment to address contract closeout challenges, gained insight into the extent of the Department's contract closeout backlog, and has initiatives underway to address a portion of the backlog. The report mentions DHS's ongoing efforts to address low-risk, firm-fixed-priced contracts as an illustration of one of those initiatives. DHS remains committed to limiting the

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government ' s exposure to financial risk by ensuring contracts are closed in a timely manner.

The draft report contained one recommendation for DHS, with which the Department non concurs. Please see attached for our detailed response to the recommendation.

Again, thank you for the opportunity to review and comment on this draft report. Technical comments were previously provided under separate cover. Please feel free to contact me if you have any questions. We look forward to working with you again in the future.

Sincerely,

Jim H. Crumpacker

Director

Departmental GAO-OIG Liaison Office

Attachment

Page 2

GAO recommended that the Secretary of Homeland Security:

**Recommendation 1:**

Develop a means , either at the agency or the Component level, to track where contracts are in the closeout process, and establish goals and performance measures for closing contracts.

**Response: Non Concur.**

The Department does not concur with developing a means to track where contracts are in the closeout process. While the Department agrees that contract closeout is a critical step in the procurement process, contract close out activities are limited to available resources. The Department does not have a tool that tracks where a contract is in the closeout process. Obtaining such a tool would require DHS to reduce its contract close out activities to fund a tool that could track status of non-linear manual tasks. Also, the Department is unable to develop a means , either at the agency or Component level, to track where contracts are in the

closeout process. Contract closeout is a manual paper and research process that requires customization for each action and constant manual data entry. Both of these tasks are labor- and time-intensive and impede DHS' s ability to close contracts in a timely manner. Moreover , even if such a means were available , it would not provide DHS with an effective way to remove bottlenecks from the closeout process.

Notwithstanding this, the Department remains committed to improving the closeout process, and to that end gathers information on the number of contracts that have been closed and are eligible for closeout. This information is reported to the Office of the Chief Procurement Officer (OCPO) , and the Chief Procurement Officer uses this information to monitor each contracting activity' s effort to reduce its backlog of open, but physically complete, contracts. The Department believes that it is more effective to continue to prudently close contracts, as efficiently as possible, based on risk, rather than to divert resources to augment our tracking system.

To identify challenges in the closeout process, and to find areas of improvement, OCPO will establish a working group, comprised of representatives of each contracting activity and each Component Office of the Chief Financial Officer. This working group will assess the current close out metrics and performance measures and recommend improvements. Additionally , this working group will assess the list of open but physically complete contracts, prioritize contracts for

closeout, and monitor progress on reducing the overall backlog. The working group will also assess whether there are any feasible tools available, within DHS' s fiscal constraints, that could provide valuable information on the contract close out process. Recommendations from the working group will be used to improve the closeout process. Estimated Completion Date (ECD): November 30, 2018.

In addition, OCPO will continue to monitor the unique contracting activity targets for contract close out in order to ensure progress on reducing the backlog of over aged open but physically complete contracts. The targets will be based on the resources available to the contracting activity and the complexity of the contracts awaiting closure . ECD: November 30, 2018

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## Text of Appendix III: Comments from the Department of State

### Page 1

Dear Mr . Johnson:

We appreciate the opportunity to review your draft report,

"FEDERAL CONTRACTING: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog" GAO Job Code 100964.

The enclosed Department of State comments are provided for incorporation with this letter as an appendix to the final report.

If you have any questions concerning this response, please contact Raymond Bouford, Director, Office of Acquisitions Management, Bureau of Administration at (703) 875-5429.

Sincerely,

Christopher H. Flaggs

Enclosure:

As stated

cc: GAO - Timothy DiNapoli A - Harry Mahar (Acting) State/OIG - Norman Brown

### Page 2

Department of State Comments on GAO Draft Report, FEDERAL CONTRACTING: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog (GAO-17-738, GAO Code 100964)

Thank you for the opportunity to comment on the GAO draft report, entitled "Federal Contracting: Additional Management Attention and Action Needed to Close Contracts and Reduce Audit Backlog."

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**Recommendation:**

We are recommending that the Secretary of State develop a means at the agency level to track data on the entirety of the number and type of contracts eligible for closeout, where the contracts are in the closeout process, and establish goals and performance measures for closing contracts.

**Department of State agrees with the recommendation.**

Based on lessons learned from previous audit findings, the Department redesigned the contracts writing system to require more accurate ultimate end dates to better reflect the base and all option years for new awards. Additionally the Office of Acquisitions Management has mandated an electronic filing system that will enable the Department to better track contracts eligible for close out and prompt attention by the Contracting Officer when required actions are necessary. In the short term, we will prioritize close out actions based on dollar value to coincide with limited resources to accomplish necessary actions. Early de-obligation of unneeded funding will be the top priority.

An enhancement priority for the electronic filing system is to develop a mechanism to track contracts in the close out life cycle. Goals and performance measures will be developed once a baseline is established in the automated system. We anticipate completion by December 31, 2019 but all system development and performance measurement is contingent upon budget and staffing limitations.

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