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United States General Accounting Office
Washington, DC 20548

National Security and
International Affairs Division

B-284368

March 10, 2000

The Honorable William S. Cohen
The Secretary of Defense

Subject: Contract Management: DOD Could Benefit From the Use of Internal Recovery Auditing

Dear Mr. Secretary:

The Fiscal Year 1996 National Defense Authorization Act required the Secretary of Defense to conduct a demonstration program to evaluate the feasibility of using private contractors to identify overpayments the Department of Defense (DOD) has made to vendors. The program began in September 1996, when the Defense Supply Center, Philadelphia, competitively contracted with Profit Recovery Group International (PRGI).¹ Section 388 of the Fiscal Year 1998 National Defense Authorization Act authorized continuation and expansion of the program.

In December 1998, we reported that the concept of “recovery auditing” offers potential to identify and recover overpayments through both internal DOD and external contractor efforts and recommended that DOD look into the cost-effectiveness of making moderate internal efforts to recover overpayments before awarding contracts for such efforts.² Although DOD concurred with our recommendation, officials from the Defense Finance and Accounting Service recently stated that they did not have the resources to do internal audits and planned no action to implement our recommendation.

One of PRGI’s steps in identifying overpayments was to ask, by letter, that vendors provide statements of their accounts with the government. This technique led to the recovery of \$957,000 from one vendor. In addition, vendors identified another \$1.75 million in overpayments that were outside the scope of the PRGI contract, either because they were not within the contractual review period or were related to another government agency.

In our December 1998 report, we concluded that DOD could take a number of steps to improve its use of recovery auditing, particularly as it considers using the concept at other DOD activities. During the course of our review, we learned that Wal-Mart

¹ PRGI is a public company and provider of recovery audit services. For the demonstration program, PRGI receives a fee of 20 percent of net collected funds.

² *Contract Management: Recovery Auditing Offers Potential to Identify Overpayments* (GAO/NSIAD-99-12, Dec. 3, 1998).

stores and the Army and Air Force Exchange Service perform internal recovery audits before contracting with an external group. Through this approach, they obtain recoveries on the most easily identified claims, while external groups (which under current DOD contracts retain between 17 and 25 percent of recovered funds) concentrate on more complex claims. Last year, the Exchange Service recovered \$7.8 million through internal recovery auditing.

As you may know, DOD is expanding its use of recovery auditing. In June 1999, the U.S. Transportation Command contracted for recovery auditing services. And in September 1999, the Defense Logistics Agency awarded contracts for recovery audits at four supply centers.

We believe that the Defense Contract Audit Agency (DCAA) is uniquely suited to perform internal recovery audits at other DOD activities and through them potentially recover millions of dollars in overpayments to vendors. The agency currently performs audits, including post-award contract audits, for DOD. Almost 4,000 DCAA personnel are located at a headquarters, five regional offices, and more than 300 field audit offices throughout the United States and overseas. A permanent staff of DCAA auditors is also located at the facilities of contractors that are awarded large contracts. In discussions with DCAA officials, they indicated that performing recovery audits is compatible with agency capabilities.

RECOMMENDATION

By using the DCAA to perform recovery audits, DOD would have the opportunity to recover at least some overpayments made to vendors before awarding contracts in the private sector for such services. Accordingly, we recommend that you require the Director of DCAA to offer internal recovery auditing services to DOD activities.

You are required by 31 U.S.C. 720 to submit a written statement on actions taken on this recommendation to the Senate Committee on Governmental Affairs and the House Committee on Government Reform not later than 60 days after the date of this report. A written statement must also be sent to the Senate and House Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

AGENCY COMMENTS

In commenting on a draft of this report, DOD stated that, prior to taking a position on any recommendation, it would need to review the proposal on a cost benefit basis and evaluate whether DCAA is the proper agency for this tasking. It stated that DCAA does not perform audit work for every contracting activity and those activities that are now contracting with private corporations to perform recovery audits are not currently serviced by DCAA. (DOD's comments are contained in appendix I.)

While we believe DOD should carefully examine the cost and benefits of its potential actions, we believe the recovery audit program conducted by the Defense Supply Center, Philadelphia, provides ample evidence of the benefits of performing the

simple, initial recovery steps within DOD. As discussed in this report, a request for a statement of accounts with the government identified \$2.7 million in overpayments. Further, much of DOD's contract spending goes to contractors reviewed by DCAA: about three-quarters of \$70.6 billion in contract payments made by the Defense Finance and Accounting Service, Columbus in fiscal year 1999 went to just 200 contractors, most (176 of the 200) subject to review by DCAA. We believe that performing low-cost recovery audit efforts, such as sending letters to vendors requesting that they provide a statement of their accounts with the government, is compatible with DCAA's competencies and could result in the identification and recovery of millions of dollars. Further, it should be noted that DCAA performs work for the Army's Tank-Automotive and Armament Command, which plans to award a contract for recovery auditing in March 2000.

We are sending copies of this report to appropriate congressional committees. Copies of this report will also be made available to others upon request. Please contact me on (617) 565-7500, if you or your staff have questions concerning this report. Major contributors to this report were Daniel J. Hauser and Karen S. Zuckerstein.

Sincerely yours,

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive, flowing style.

David E. Cooper
Associate Director
Defense Acquisitions Issues

Enclosure



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

FEB 17 2000

Mr. David E. Cooper
Associate Director, Defense Acquisitions Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the GAO draft report, "CONTRACT MANAGEMENT: DoD Could Benefit From the Use of Internal Recovery Auditing," dated January 7, 2000, (GAO Code 707473/OSD Case 1938).

GAO recommends that the Secretary require the Director of the Defense Contract Audit Agency to offer internal recovery auditing services to DoD activities.

The Department's response to the recommendation is contained in the enclosure.

Sincerely,

A handwritten signature in cursive script that reads "Nelson Toye".

Nelson Toye

Deputy Chief Financial Officer

Enclosure

GAO DRAFT REPORT DATED JANUARY 7, 2000
(GAO CODE 707473) OSD CASE 1938

"CONTRACT MANAGEMENT: DoD Could Benefit From the Use of
Internal Recovery Auditing"

DEPARTMENT OF DEFENSE COMMENTS TO
THE GAO RECOMMENDATION

RECOMMENDATION: The GAO recommends that the Secretary of Defense require the Director,
Now on Defense Contract Audit Agency (DCAA) to offer internal recovery auditing services to DoD
p.2) activities. (p. 3/GAO Draft Report)

DOD RESPONSE: There is a difference between the audit work that DCAA currently performs and what is defined as internal recovery audit. Additionally, those activities at which DCAA currently performs its audit work are different than those DoD activities that are now contracting with private corporations to perform recovery audit. Further, DCAA does not now perform audit work for every DoD contracting activity and many DoD contract activities that might benefit from recovery audits are activities not currently serviced by DCAA. While DoD recognizes the potential benefit of recovery audits, the costs and benefits of DCAA expanding its effort to provide such recovery audits--rather than using private sector firms to accomplish that task--have not been defined.

While DoD recognizes that this recommendation may have merit, it can neither concur nor nonconcur at this time because the proposal arises essentially without any background. The draft report is silent on what extent of internal recovery auditing might apply to which payments at what cost for what benefit. Prior to taking a position, the Department must review this proposal on a cost benefit basis and evaluate whether DCAA is the proper agency for this tasking. Only after such an effort, which will require additional time, can the Department decide whether to implement the recommendation.

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