

---

---

# *Office of Inspector General*

# *Audit Report*

---

---

## *Closeout and Payment Processes for Cost-Reimbursable Contracts*

*Department of Transportation*

*Report Number: FI-2001-018*

*Date Issued: January 23, 2001*





# Memorandum

U.S. Department of  
Transportation

Office of the Secretary  
of Transportation  
Office of Inspector General

Subject: **ACTION: Report on Closeout and Payment Processes  
for Cost-Reimbursable Contracts, DOT  
FI-2001-018**

Date: January 23, 2001

From: Alexis M. Stefani   
Assistant Inspector General for Auditing

Reply To

Attn Of: Meche:x61496

To: Assistant Secretary for Administration

This report presents our audit results on closeout and payment processes for cost-reimbursable contracts within the Department of Transportation (DOT) and its Operating Administrations. We excluded the Federal Aviation Administration (FAA) because it uses a different acquisition system from the rest of DOT. FAA payment and closeout processes will be addressed in a separate audit to be started in March 2001.

Use of cost-reimbursable contracts is more risky for the Government because contractors generally have little incentive to control costs. Thus, contracting officer oversight is essential to protect the Government's interest. Our audit objective was to determine whether DOT was properly administering closeout and payment of cost-reimbursable contracts in accordance with applicable acquisition regulations and guidance.

## **RESULTS-IN-BRIEF**

DOT was not properly administering closeout and payment of cost-reimbursable contracts. Until 1996, funding for audits of contracts was included in the Office of Inspector General (OIG) budget. DOT and its Operating Administrations would request audits of specific contracts, and OIG would contract with the Defense Contract Audit Agency (DCAA) to perform independent audits. Contract audits are performed to determine whether costs claimed by contractors were incurred and allowable. For Fiscal Year (FY) 1996, DOT received 397 contract audits. After DOT internal agencies took over the responsibility for contract audits, the number of requested audits began to drop. For FY 1999, 68 contract audits were received from DCAA.

During the 5 years ended April 2000, DOT closed 864 cost-reimbursable contracts valued at about \$559 million. We reviewed 40 of these contracts that accounted for about \$120 million, and found:

- Of the 40 contracts, 29 totaling about \$62 million were closed without independent audits or internal desk audits to ensure DOT only paid allowable costs. Of the 13 contracts over \$3 million in our sample, 11 were not independently audited as required. These audits determine whether costs were incurred and allowable. For example, proper audits of one contract resulted in about \$62,000 being returned to DOT.
- None of the 40 contract files contained certified contractor incurred cost proposals required annually for contracting officers' use to assess the accuracy of contractors' annual costs and billing rates.
- Billing rates on 21 of the 40 contracts, totaling \$25 million, were not properly adjusted during contract performance, which can result in overbilling. For example, on one contract in which rates were properly reviewed and adjusted, the contractor had to return about \$10,000 of overbilled costs.
- Of the 40 contracts, 10 totaling \$6 million were awarded without determining whether contractors' accounting systems were adequate to handle cost-reimbursable contracts, as required by Federal regulations.
- Of the 40 contracts, 8 totaling about \$5 million had little oversight throughout the life of the contract. For example, one contractor was paid about \$1.3 million, the exact amount of the initial estimate, without an independent audit or internal desk audit; without determining whether the contractors' accounting system was adequate; without certified contractor incurred cost proposals; and without monitoring of the billing rates.

We reported<sup>1</sup> that DOT did not close contracts in a timely manner, resulting in funds remaining obligated on completed contracts for as long as 12 years. At least \$35.4 million no longer represented valid liabilities. DOT had 419 cost-reimbursable contracts, with obligations of \$232 million, that were 1 to 9 years overdue for closure.

Because contracting officers were not performing these crucial reviews or requesting independent audits, DOT has little assurance that contractors actually

---

<sup>1</sup> Report on Inactive Obligations on DOT Contracts, Report Number FI-2000-125, September 25, 2000.

incurred the \$294 million that was paid on the 448 cost-reimbursable contracts that were not subjected to independent audits and internal desk audits.

To adequately protect the Government's interest on cost-reimbursable contracts, DOT contracting officers need to obtain independent audits, perform internal desk reviews, determine in advance that contractors have adequate accounting systems, monitor and adjust billing rates, identify open contracts that are ready for closure and close them timely, and establish contract tracking systems. For added emphasis, the performance agreement that each head of an Operating Administration has with the Secretary of Transportation should include a requirement that these actions are accomplished.

DOT concurred with the findings and recommendations and agreed to implement corrective actions. DOT also disclosed that there had been significant staffing reductions in the number of contracting personnel during the period covered by this review. The Office of the Senior Procurement Executive for DOT has developed an action plan, which will be implemented in conjunction with the Procurement Management Council, to improve cost-reimbursable contract administration. The action plan has completion dates ranging from April 2001 to March 2002.

## **BACKGROUND**

The Federal Acquisition Regulation (FAR) is the primary source of policies and procedures Federal executive agencies must use to administer contracts. DOT issued the Transportation Acquisition Regulations and the Transportation Acquisition Manual to supplement the FAR.

The FAR, Part 16 and related guidance, requires contracting officers to actively administer cost-reimbursable contracts because these types of contracts are the riskiest for the Government. These contracts are more risky because contractors do not have a strong incentive to control costs. To actively administer cost-reimbursable contracts, FAR requires that contracting officers obtain required audits, determine whether contractors' accounting systems are adequate to administer cost-reimbursable contracts, and make needed adjustments to costs during contract performance. FAR also requires that cost-reimbursable contracts be closed within 3 years after performance completion.

## **SCOPE AND METHODOLOGY**

The audit was conducted from April through October 2000 at DOT Headquarters and the headquarters of the United States Coast Guard, Federal Highway Administration, Federal Railroad Administration, Federal Transit Administration,

National Highway Traffic Safety Administration, Maritime Administration, Research and Special Programs Administration (including the Volpe National Transportation Systems Center) and the Transportation Administrative Service Center. We conducted the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

FAA was excluded from this audit because it is not subject to the FAR. FAA has its own acquisition regulation, the Acquisition Management System, and is exempt from FAR provisions by Section 348 of Public Law 104-50, entitled "Department of Transportation and Related Agencies Appropriations Act, 1996."

Our audit procedures included interviewing appropriate DOT and Operating Administration officials, reviewing pertinent Federal and departmental acquisition regulations and guidance, and reviewing contract files for a nonstatistical sample of 40 contracts totaling about \$120 million. We selected the 40 contracts from the DOT Contract Information System listing of 864 cost-reimbursable contracts, valued at about \$559 million, that were closed between April 1995 and April 2000. We did not validate the accuracy of the information in the DOT Contract Information System.

We reviewed 13 high-dollar-value contracts (contracts individually valued at over \$3 million), totaling about \$102 million, and 27 low-dollar-value contracts (contracts individually valued at \$3 million or less) totaling about \$18 million. To accomplish our audit objective, we reviewed contract files to determine whether the various Federal and DOT billing and closing procedures were accomplished.

We also obtained and analyzed a listing of 419 cost-reimbursable contracts that had been physically completed for at least 3 years, but still not closed, from the DOT Contract Information System as of April 3, 2000. We also requested and reviewed available contract tracking system listings from each Operating Administration.

## **ANALYSES AND RESULTS**

DOT and its Operating Administrations were not properly administering closeout and payment of cost-reimbursable contracts in accordance with applicable acquisition regulations and guidance, or closing out contracts in a timely manner.

### ***Contract Closeout Process***

Contracting officers generally were not closing contracts properly. According to FAR and supplemental DOT guidance, for high-dollar-value contracts (over \$3 million), contracting officers must obtain an independent contract audit before

closing a contract. For low-dollar-value contracts, if the contract has been adequately administered and meets specific regulatory requirements, the contracting officer may negotiate the costs, using "quick closeout" procedures in lieu of requesting an independent audit.

DOT guidance for high-dollar-value contracts requires closeout audits whereas the contracts identified for quick closeout permit the use of either a formal closeout audit or a desk audit. A desk audit has a more limited scope than a formal audit and is generally done by the in-house contracting staff. However, the accuracy of contract amounts must still be established regardless of which process is used.

### **High-Dollar-Value Contracts**

For the 13 high-dollar-value contracts, totaling about \$102 million, we found that 6 contracts were closed by the contracting officers without determining whether annual incurred costs billed to the Government were accurate. For contracts more than \$3 million, the contractors' incurred costs must be independently audited for each year of the contract to determine that only allowable costs were billed. In addition to not having annual audits of the incurred costs, 11 of the 13 contracts totaling \$52 million were closed without an independent audit.

Closing audits can identify inappropriate charges. For one contract that had the required prior year incurred cost audits and the independent closing audit performed, the audits identified \$62,000 of inappropriate charges, which the contractor returned.

We found that independent audits were not requested because contracting officers did not follow the Federal and departmental regulations. For example, two of the contracts were closed as quick closeout audits despite being over the \$3 million threshold required for an independent audit. The contracting officers informed us it was due to oversight. On two other contracts the contracting officers waived closing audits; however, neither FAR nor departmental guidance allows contracting officers to waive audits on high-dollar-value contracts.

### **Low-Dollar-Value Contracts**

For the 27 low-dollar-value contracts, totaling \$18 million, we found:

- 19 contracts totaling \$10 million were closed without determining whether annual incurred costs were accepted by the Government. For low-dollar-value contracts, audits may be requested; however, at a minimum, desk audits of the contractor's cost submissions should be conducted to determine the acceptability of costs.

- 18 contracts totaling \$9.8 million were closed without an independent audit or desk audit being performed. This process determines whether any money is due the Government. For one contract that had an adequate desk audit, the contractor was required to return over \$3,000 to DOT.

The DOT Contract Information System as of April 3, 2000, included about \$126 million of completed contracts individually valued at \$3 million or less that had not been closed. Due to the significant amount of cost involved, desk audits should be performed to protect the Government's interests.

### ***Contract Payment Process***

Contracting officers were not adequately administering the contract payment process. Consequently, the Government has little assurance that it is being billed the proper costs during contract performance.

Before a cost-reimbursable contract is awarded, FAR requires that the contracting officer determine whether contractors' accounting systems are adequate to track costs by contract. Contractors submit periodic interim billings to receive payment for services provided throughout contract performance. The costs billed should be the actual direct costs such as labor, and estimated indirect costs such as general and administrative costs. Not later than 6 months after the close of a fiscal year, a contractor must provide a certified incurred cost proposal that states the actual allowable direct and indirect costs it has incurred throughout the fiscal year. At the same time, the contractor should submit an adjustment voucher to recover underpayments or remit overpayments due to differences between estimated and actual indirect costs.

Our review of the contract files disclosed:

- None of the 40 contract files totaling about \$120 million contained certified annual incurred cost proposals. The certified proposals are used as the baseline to set subsequent year billing rates on multi-year contracts. These proposals also are used by DCAA as the baseline for conducting independent audits, and these proposals are necessary to determine cost reasonableness for desk audits.
- Four of the high-dollar and 17 of the low-dollar-value contract files totaling about \$25 million did not properly reflect changed billing rates during contract performance. Billing rates should change because contractors' costs used to develop billing rates change. For example, on one contract in which the contractor properly adjusted its billing rates, the contractor's overhead rate changed during the year from the estimated and billed 45 percent to an actual rate of 39 percent, the general and administrative rate changed from 10 percent to 7 percent, and the subcontract administrative rate changed from 5 percent to

3 percent. Consequently, the contractor had overbilled the Government during the year and used an adjustment voucher to return more than \$10,000.

- Ten of the low-dollar contract files totaling about \$6 million did not contain the required accounting system adequacy determination. FAR requires that the contracting officer make this determination based on prior experience with the contractor or by requesting an accounting system audit. Without this determination the Government does not know whether the contractor has an adequate accounting system to ensure it is paying only proper costs.

We found that eight contracts, totaling about \$5 million and representing four Operating Administrations, reflected little contracting officer administration of the payment and closing processes from start to finish. Specifically, we found no determination of accounting system adequacy before contract award, no monitoring of billing rates during contract performance, and no closing audit or desk audit performed before closing the contract. For example, although the contract lacked proper oversight from start to finish, a contractor billed, and was paid, the entire originally estimated \$1.3 million for the contract.

Because contracting officers did not adequately obtain independent audits, perform desk audits or make accounting system adequacy determinations, obtain annual incurred cost proposals or monitor and adjust contract billing rates on a systematic basis, the Government has little assurance that contractors actually incurred the amounts billed on those contracts that were closed in the last 5 years.

***Timely Contract Closeout***

The FAR requires that cost-reimbursable contracts be closed within 3 years of completion. We obtained a listing of cost-reimbursable contracts from the DOT Contract Information System for contracts completed for more than 3 years, but still not closed as of April 3, 2000. The listing included 419 such contracts, valued at about \$232 million. The following chart shows the distribution of the contracts by age.

Years Contract Completed	Number of Contracts	Dollar Value of Contracts (in millions)
3 to 4 years	210	\$142
5 to 6 years	176	61
7 to 12 years	<u>33</u>	<u>29</u>
<b>Total</b>	419	\$232



Operating Administration personnel indicated that they were not closing contracts in a timely manner because of staffing constraints and a low priority assigned to the contract closing process.

To ensure that contracts are closed within the proper timeframe, the Transportation Acquisition Manual requires that each Operating Administration establish and maintain a contract tracking system. The tracking systems are to be used to identify those contracts that are complete and ready to be closed. We found most of the Operating Administrations were not maintaining adequate contract tracking systems. Specifically, when we requested the required listing of contracts physically completed but not closed, only the Coast Guard and Volpe Center provided adequate listings. The lack of adequate tracking systems contributes to contracts not being closed in a timely manner.

We observed the Volpe Center has an adequate contract tracking system and has aggressively pursued contract closeout. As a result, during the period from April 1999 through August 2000, it closed 378 contracts and deobligated more than \$5 million.

Another advantage of having adequate closeout procedures is that unneeded funds may be made available for other uses. In a separate report,<sup>2</sup> we identified \$35.4 million that could be put to better use by monitoring contract obligations, including closing contracts in a timely manner.

By giving the contract closeout process more attention, and establishing and maintaining the required contract tracking systems, DOT contracting officers should be able to more quickly identify and close contracts in accordance with FAR requirements. Also, for added emphasis, the performance agreement that each head of an Operating Administration has with the Secretary of Transportation should include a requirement that these contract oversight deficiencies are addressed and corrected.

## **RECOMMENDATIONS**

We recommend that the Assistant Secretary for Administration in coordination with the DOT Operating Administrations:

1. Issue guidance reemphasizing that contracting officers:
  - a. Obtain independent contract audits before closeout for contracts more than \$3 million, and request contract audits or perform desk audits for contracts of \$3 million or less.

---

<sup>2</sup> Report on Inactive Obligations on DOT Contracts, Report Number FI-2000-125, September 25, 2000.

- b. Determine, before contract award, that contractors' accounting systems are adequate to administer cost-reimbursable contracts and document the determination in contract files.
  - c. Monitor contractor billing rates during contract performance and adjust contract amounts where warranted.
  - d. Identify all open contracts for which contract performance has been completed 3 years or longer and implement a plan with milestones to properly close these contracts.
2. Develop and maintain contract-tracking systems within each Operating Administration.
  3. Include contract oversight and close-out process requirements in performance agreements between the Secretary of Transportation and the heads of Operating Administrations.

#### **MANAGEMENT COMMENTS**

A draft of this report was provided on January 5, 2001, to the DOT Assistant Secretary for Administration; the Assistant Secretary for Budget and Programs/Chief Financial Officer; the Heads of DOT Operating Administrations; and the Director, Transportation Administrative Service Center. The Assistant Secretary for Administration concurred with all recommendations and provided a detailed action plan with target completion dates of April 2001 for Procurement Management Council participation, best practices, and updating diagnostic framework; June 2001 for assessment of alternatives for contract audit function; September 2001 for tracking contract closeouts; and March 2002 for training all acquisition personnel. The complete text of management comments is in the appendix to this report.

#### **OFFICE OF INSPECTOR GENERAL COMMENTS**

Actions taken and planned are reasonable, subject to timely implementation. We will continue to monitor implementation and followup on these corrective actions. These recommendations are subject to the audit followup requirements of DOT Order 8000.1C.

We appreciate the courtesies and cooperation of DOT and Operating Administration representatives. If you have questions, please call me at (202) 366-1992 or John Meche at (202) 366-1496.

#



**U.S. Department of  
Transportation**  
Office of the Secretary  
of Transportation

# Memorandum

Subject: **ACTION**: Response to Draft Report on Closeout  
and Payment Processes for Cost-Reimbursable  
Contracts

Date: January 12, 2001

From: Melissa J. Allen /original signed by/  
Assistant Secretary for Administration

Reply to  
Attn. of:

To: John L. Meche  
Assistant Inspector General

## **OVERVIEW**

The Office of Inspector General (OIG) draft report raises a number of issues that need to be addressed to improve cost-reimbursable contract administration within the Department. In response to the report, the Department's Senior Procurement Executive (SPE) has developed an Action Plan, included as Attachment 1, which enumerates actions to address these issues. This action plan, which will be implemented in conjunction with the Procurement Management Council, will provide specific measures to improve cost-reimbursable contract administration. These measures include:

- Reviewing regulations and internal policies/procedures for cost-reimbursable contract administration to ensure there are no conflicts. This will include an analysis of the Transportation Acquisition Manual 1242.708 recommended \$3 million threshold for quick closeout audits.
- Issuing comprehensive guidance reemphasizing acquisition policies as they relate to cost-reimbursable contract administration. This guidance will specifically address: appropriate use of desk audits, the requirement for independent contract audits, the requirement for determining accounting systems adequacy, and the need for monitoring and adjusting billing rates.
- Identifying training needs to improve performance in the areas of concern raised in the report.
- Issuing additional guidance on tracking contract closeouts.
- Determining the most appropriate approach to share best practices throughout the Department of Transportation (DOT) community.

- Updating DOT's Procurement Performance Management System (PPMS) to include an empirical measure of contract closeouts and the administration and closeout of cost-reimbursable contracts as special emphasis items in the Diagnostic Pathway. Since the PPMS is part of DOT's Performance Plan and the Secretary's Performance Agreements with the Operating Administrators, it will ensure senior management attention to these issues.
- Assessing alternatives for the contract audit function.

## **BACKGROUND**

While we fully agree that action is needed to improve contract administration and closeout in the Department, and are taking the steps identified elsewhere in this response, it is useful to understand some of the issues that have occurred over the last few years, that have had some impact on contract management. This information is provided to enhance understanding of the context within which contract administration has had to function, and is not intended to diminish the need for actions to improve contract administration.

Contract administration has been under severe resource pressure over the last several years. Resources available to perform contracting activities have been drastically reduced. Within DOT, the number of contract specialists was reduced from 1100 in 1993 to approximately 650 in 2000. This 40 percent reduction has had an impact on some of the functions that need to be accomplished in the acquisition community. Also, in the past, operating administrations (OA) have been able to supplement their staffs with resources from the Defense Contract Management Command (DCMC). DCMC no longer offers these services to other agencies therefore the OA's are continually short staffed. Historically, when resources are decreased, the area of contract closeouts becomes the lowest priority for any acquisition organization. Additional resource pressure was applied when the responsibility for requesting and tracking contract audits was transferred from the Office of Inspector General (OIG) to the OA's. Although responsibility was reassigned, the OA's were not provided the additional resources needed to accomplish the additional tasks associated with the audits. As a result, OA's must now fund the audits and existing personnel to conduct these audits and/or audit related tasks.

## **SPE Will Issue Comprehensive Guidance**

After a detailed review of the Federal Acquisition Regulation and Transportation Acquisition Manual coverage, the SPE plans to issue comprehensive guidance to the procurement community reemphasizing acquisition policies as they relate to cost-reimbursable contract administration. Contracting Officers will be reminded that due to the nature of cost-reimbursable contracts, cost reimbursement contracts should only be awarded to contractors with acceptable accounting systems. The appropriate use of desk audits by the contracting officer will be addressed, as will the requirements for determining the need to conduct an independent audit prior to contract closeout.

Further emphasis will be placed on the need for better administration of cost-reimbursable contracts as it relates to contractor billing rates and the need for adjusting contract amounts when warranted. Acquisition personnel will be advised that contract closeout will be considered a special item of interest in DOT's balanced scorecard and that a tracking system will be required to ensure timely contract closeouts.

Representatives from all OA's will participate in evaluating the DOT acquisition and technical personnel training needs with respect to awarding and administering cost-reimbursable contracts. The results will be used to develop a new required training course, as well as a refresher course for those employees involved in cost-reimbursement contract administration. An intranet site is being considered as a means to share best practices with the DOT acquisition community. In addition, the guidance will forward an update for DOT's PPMS to include both an empirical measure on contract closeouts and to include the administration and closeout of cost-reimbursable contracts as a special emphasis item in the Diagnostic Pathway.

## **RECOMMENDATIONS AND RESPONSE**

The OIG report recommends that the Assistant Secretary for Administration in coordination with the DOT OA's:

### **Recommendation 1:** Issue Guidance reemphasizing that contracting officers:

- a. Obtain independent contract audits before closeout for contracts over \$3 million, and request contract audits or perform desk audits for contracts of \$3 million or less.
- b. Determine, before contract award, that contractors accounting systems are adequate to administer cost-reimbursable contracts and document the determination in contract files.
- c. Monitor contractor billing rates during contract performance and adjust contract amounts where warranted.
- d. Identify all open contracts for which contract performance has been completed 3 years or more and implement a plan with milestones to properly close these contracts.

**Response:** Concur. After reviewing the issues raised in the report, we acknowledge the benefit of reemphasizing the policies and procedures for the administration of cost reimbursement contracts. Following an assessment of the regulations, internal procedures and the needs of the DOT acquisition

community, the SPE intends to issue comprehensive guidance as stated above and outline the proposed action plan.

**Recommendation 2:** Develop and maintain contract-tracking systems within each operating administration.

**Response:** Concur. We agree that a contract tracking system is necessary in each OA. As stated above, the SPE will ensure that each OA has implemented an acceptable tracking system no later than September 2001 to track contract closeouts.

**Recommendation 3:** Include contract oversight and closeout process requirements in performance agreements between the Secretary of Transportation and the Heads of Operating Administrations.

**Response:** Concur. We plan to update DOT's PPMS to include both an empirical measure on contract closeouts and to include the administration and closeout of cost-reimbursable contracts as a special emphasis item in the Diagnostic Pathway. The PPMS is included in DOT's Performance Plan and the Secretary's Performance Agreements with the Operating Administrators.

Thank you for the opportunity to comment on the draft report. Please contact David Litman, Senior Procurement Executive, on 366-4263 with any questions.

Attachment

cc: Ms. Espenshade, M-60  
Mr. Gertel, M-1

**ACQUISITION ACTION PLAN FOR IG ISSUES RAISED ON  
CLOSEOUT AND PAYMENT OF COST REIMBURSABLE CONTRACTS**

**PMC PARTICIPATION** -- Target completion -- April 2001

- Policy review of regulations/internal guidance
- Discuss concerns with PMC at the upcoming January PMC meeting
- Establish working group with representatives from each OA to participate in the implementation of the action plan
- Issue updated guidance/policy to acquisition community stressing concerns

**TRAINING** -- Target completion -- March 2002

- Meet with the representatives from each OA to discuss the development, funding and completion of initial and refresher training for personnel involved in acquisition.
- Develop an agreement to fund training
- Develop SOW for training
- Develop material for course
- Incorporate training material into COTR training courses
- Ensure all acquisition personnel complete the initial training and establish a timeframe for refresher training

**TRACKING OF CONTRACT CLOSEOUTS** -- Target completion -- September 2001

- Assess ability of PRISM to generate canned reports to track contract closeout status
- Issue requirement for tracking of contract closeouts
- Develop performance measure for completion of contract closeouts
- Develop baseline
- Verify tracking being used within each OA

**BEST PRACTICES** -- Target completion -- April 2001

- Assess intranet as a tool to share best practices

**UPDATE DIAGNOSTIC FRAMEWORK** -- Target completion -- April 2001

- Issue guidance for inclusion in the 2001 performance measures
- Emphasize closeout and payment processes for cost-reimbursable contracts

**ASSESSMENT OF ALTERNATIVES FOR CONTRACT AUDIT FUNCTION** --  
*Target completion -- June 2001*

- Determine requirements of each OA
- Pros/Cons of current audit process
- Look at possibility of transferring responsibility/funding to central organization