



April 29, 2015

MEMORANDUM FOR: Ellen Herbst
Chief Financial Officer and Assistant Secretary for Administration

FROM: Andrew Katsaros
Principal Assistant Inspector General for Audit and Evaluation

SUBJECT: Incorporating Audits into Contract Administration Planning
and Performance at the Department of Commerce

In this memorandum, we discuss the value of following Federal Acquisition Regulation (FAR) guidance in planning, designing, and executing Departmental audits of contractors. While the Department's Office of the Chief Financial Officer currently evaluates acquisition activities and programs according to the Commerce Acquisition Regulation (CAR), we note that amounts budgeted for audits of the Department's contractors are inadequate and therefore do not allow the Department to identify potential cost savings (see **section I**). We are also concerned with a lack of coordination between the Department and its bureaus when planning for audits of its contractors (see **section II**). To improve the effectiveness and efficiency of the entire Department's contract administration, we offer **recommendations** to the Director of Acquisition Management.

Background

To strengthen oversight of agency acquisition activities, Congress enacted the Services Acquisition Reform Act of 2003, which established Chief Acquisition Officers and Senior Procurement Executives at many major federal agencies, including the Department of Commerce. The Chief Acquisition Officer is responsible, in part, for monitoring and evaluating the performance of acquisition activities and programs of the agency. Working with the Chief Acquisition Officer,¹ the Senior Procurement Executive is responsible for direction of the procurement system of the agency, including implementation of unique procurement policies, regulations, and standards. Within the Department, the Senior Procurement Executive is responsible for policy and oversight of the Department's acquisition program and the Director of Acquisition Management manages the day-to-day operations of acquisition, although each bureau typically conducts its own contracting activities. The Senior Procurement Executive is located in the Office of the Chief Financial Officer.

¹ At the Department of Commerce, the Chief Acquisition Officer is also the Chief Financial Officer and Assistant Secretary of Administration.

I. Audits of Commerce Contractors Are Inadequate

FAR subpart 42.1 identifies the Defense Contract Audit Agency (DCAA) as the cognizant federal entity for audits of most federal contractors. OIG is concerned that the Department is not adequately leveraging contract audit services such as those offered by DCAA. In FY 2014, for example, the U.S. Patent and Trademark Office (USPTO) budgeted only \$50,000 for DCAA contract audits across an award universe of \$903 million. For fiscal years 2011–2015, the National Oceanic and Atmospheric Administration (NOAA) budgeted only \$238,000 for the same purpose—amounting to less than \$50,000 per year to audit an annual contract universe of over \$1.3 billion. This amount may not cover even one audit of a NOAA contractor’s costs for a single year.

Department of Commerce bureaus develop acquisition plans to execute contracts for goods and services. Once a contract is awarded, the contract is managed by contracting officers and contract administrators. Properly administering a contract and overseeing the associated contractor requires a series of tasks. The tasks vary according to the contract type (e.g., cost-type or fixed-price) and the difficulty in performing the contract to provide the good or service. For example, a research and development contract may be significantly more difficult to administer than a grounds maintenance contract. A listing of many contract administration functions can be found in FAR 42.302. Contract administrators perform these tasks with help from specialists in technical and auditing fields. Examples of audit-related contract administration tasks from FAR 42.302 include

- reviewing a contractor’s compensation structure and insurance plans;
- determining the allowability of costs suspended or disapproved and approving final vouchers;
- establishing contractor final indirect cost rates and billing rates;
- evaluating compliance with Cost Accounting Standards and related disclosure statements;
- determining the adequacy of a contractor’s accounting system;
- reviewing and approving or disapproving contractor requests for payments;
- ensuring timely notification by the contractor of any anticipated overrun or underrun of the estimated cost under cost-reimbursement contracts;
- monitoring a contractor’s financial condition and advising contracting officers when contract performance is in jeopardy; and
- taking action to recover overpayments from contractors.

All of the above services can be performed by qualified auditors who provide their results to contract administrators as advisory audit reports, meaning that the audit results are nonbinding and not subject to OMB Circular No. A-50 or Department Administrative Orders 213-3 and 213-5. Their expertise is useful in that it assists contract administrators in effectively and efficiently enforcing the contract’s terms and conditions.

The *Contract Acquisition Manual (CAM)* is much less detailed in identifying opportunities for contract audit services that facilitate effective and efficient contract administration. It focuses only on the contract-closeout portion. These types of audits can be useful in identifying cost savings to the government but can overlook many other opportunities for cost savings—particularly those relating to Cost Accounting Standard approvals or Termination Settlement proposals—that might be identified in a carefully designed audit plan of a contractor.

II. Commerce Contract Audit Planning Is Inadequate

The Department of Defense, an agency with sizable procurement activity, works with DCAA to identify audit opportunities. DCAA can provide a selection of pre-award, performance, and post-award audits to contract administrators from the proposal stage through contract closeout. All of the financial activities identified in FAR 42.302 for Contract Administration are currently conducted by DCAA in addition to special audits that DCAA can tailor for unique situations that may arise.

Both USPTO and NOAA have current interagency agreements with DCAA that are principally used for contract-closeout audits. A listing of large-dollar Department of Commerce contracts may identify contractors, predominantly working under contracts for which the Department of Defense has administrative cognizance, who already have DCAA staff located at the contractors' sites. But DCAA will not automatically inform other agencies such as the Department of Commerce of audit results that may affect other contracts administered by those agencies, unless the agencies' contract administration offices are actively engaged with DCAA in a coordinated audit approach for their contracts.

Such a coordinated approach would likely involve more than just performing contract closeout audits. For example, it may include reviewing changes to a Cost Accounting Standard Disclosure Statement that affect only a contractor unit performing non-Department of Defense contracts. It could also involve auditing contract termination settlement proposals that have unique rules allowing contractors to bill an agency for costs to close down a contract. A contractor could include costs unrelated to the contract in the final settlement proposal that might appear reasonable, but have never been incurred. An auditor with current knowledge of the contractor's operations can reasonably be expected to identify those costs and inform the contracting office not to pay them. Progress payment audits on fixed-price contracts are another type of contract administration audit. A progress payment, as the name implies, is an interim payment to a contractor before final completion, based on the amount of progress made. A contractor could claim more progress and request a larger payment, which puts the government at risk of financial loss if a contractor is unable to deliver the product.

These and other types of contract audits can contribute to effective and efficient administration of an agency's contracts.

Recommendations

We recommend that the Director of Acquisition Management

1. Work with bureau procurement officials to (a) identify contracts that may benefit from the use of audit support services and (b) consult with DCAA and/or independent public accounting firms about available audit support services and associated costs for the services.
2. Update the *Commerce Acquisition Manual* to include additional contract administration functions identified in Federal Acquisition Regulation 42.302.

The final memorandum will be posted on the OIG's website pursuant to section 8M of the Inspector General Act of 1978, as amended. In accordance with Department Administrative Order 213-5, within 60 days of the date of this memorandum please provide us with an action plan that responds to all of the recommendations. If you have any further questions or comments, please contact me at (202) 482-7859 or Kenneth Stagner, Regional Inspector General for Audits, at (303) 312-7650.

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