

GAO

Report to the Chairman, Committee on
Government Operations, House of
Representatives

September 1994

NASA CONTRACT MANAGEMENT

Improving the Use of DCAA's Auditing Services



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National Security and
International Affairs Division

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September 30, 1994

The Honorable John Conyers, Jr.
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

As you requested, we reviewed the National Aeronautics and Space Administration's (NASA) management and use of audit support provided by the Department of Defense's (DOD) Defense Contract Audit Agency (DCAA). NASA relies extensively on DCAA to provide audit and financial advisory services on the billions of dollars of contracts NASA awards. This report assesses NASA's (1) need for an enforcement mechanism to deter contractors from claiming unallowable costs, (2) use of DCAA proposal audit services, (3) involvement in audit planning, (4) oversight of contract audit and administration services, and (5) backlog of contracts awaiting closeout.

Background

As the second largest civilian contracting agency in the federal government, NASA depends on DCAA to ensure that contractors spend government funds in accordance with laws and regulations. DCAA services are especially important to NASA due to the agency's prominent use of cost reimbursement contracts, which accounted for over 85 percent of the \$10.2 billion worth of contracts awarded to business firms in fiscal year 1993. During each of the past 2 fiscal years, NASA paid DCAA over \$17 million to perform contract audit and other financial advisory services, such as the following:

- Evaluations of contractors' cost proposals prior to negotiating contracts, modifications, and subcontracts.
- Audits of contractors' incurred costs to verify that the amounts billed to the government under cost reimbursement and incentive contracts agree with the contractors' records, are allowable under existing regulations, are reasonable, and are allocable to the contract.
- Business system audits, such as reviews of contractors' accounting, budgeting, compensation, purchasing, and cost estimating systems, to ensure that contractors have adequate controls to effectively and efficiently manage government resources. DCAA also performs operation audits to identify areas where contractors' practices are wasteful, careless, and inefficient and result in unreasonable costs.

Results in Brief

Stronger sanctions are needed to reduce NASA contractors' unallowable cost claims. DCAA audits show that NASA contractors claim reimbursement for unallowable costs in the millions of dollars, some of which are expressly unallowable.¹ For example, at one contractor, about \$82,000 of expressly unallowable costs were allocated to NASA and another civilian agency, including costs related to business interruption insurance, charitable donations, consulting, and travel in excess of amounts allowed by travel regulations. Although NASA can disallow contractor claims for such costs, it has not had the authority to assess penalties to help enforce compliance with regulations and to serve as a deterrent to contractors claiming unallowable costs. Legislation recently passed by the Congress provides such authority.

NASA procurement personnel obtained and used DCAA contract pricing support as required or documented their reasons for not doing so. However, over 70 percent of the contracts we reviewed did not properly document the status of contractors' business systems prior to negotiations. Knowing the status of such systems is important in determining the extent to which NASA should rely on contractors' proposals and in overseeing and evaluating their performance.

NASA and DCAA have improved their communication and audit coordination in recent years; however, NASA is still not sufficiently involved in DCAA's audit planning process or aware of audit coverage to ensure that contractors received appropriate and timely audits. Consequently, limited audit resources may not have been effectively used, and NASA could not consider how areas that may require increased audit coverage would be reviewed. Such areas have been identified by the NASA Inspector General in recent years, including the lack of timely incurred cost audits and business system reviews as well as insufficient numbers of operational or functional reviews to identify contractor inefficiencies and decrease contract costs.

NASA's contract audit tracking and follow-up systems were incomplete. For example, at one center, nine reports requiring follow-up were not in the tracking system, including one that addressed about \$495,000 in defective pricing. Consequently, NASA managers did not know the status of all significant audit findings and recommendations that affected their contracts. Further, NASA was largely unaware of the status of the findings and recommendations on NASA contracts to be resolved by DOD's administrative contracting officers.

¹Expressly unallowable costs are those specifically stated to be unallowable under the provisions of an applicable law, regulation, or contract.

NASA has not taken timely action to close out contracts after work has been completed, thus increasing its exposure to contractors' financial and internal control problems and delaying corrective actions needed to prevent them from billing excessive costs on subsequent contracts. Of more than 2,600 contracts awaiting closeout at the end of 1993, over 1,500 exceeded the guidelines for timely closeout. Some of the contracts awaiting closeout were completed in the late 1970s and early 1980s.

NASA Contractors' Unallowable Cost Claims Are a Significant Problem

Our review of DCAA audit reports showed that NASA contractors' unallowable overhead cost claims are a significant problem, especially among smaller contractors with whom NASA has significantly increased the number and value of its contracts. Unallowable costs, including those that were expressly unallowable, that were found by DCAA auditors in recent years included two cases of overstating depreciation expenses by more than \$1.6 million; five cases of excessive travel and transportation claims totaling about \$230,000; six cases of alcohol and entertainment expenditures totaling about \$204,000; three cases of legal fees and settlements of over \$124,000; and five cases of improper claims for bonuses and other compensation totaling over \$515,000. These and other examples of such costs found on NASA contracts are in appendix II.

Although unallowable cost claims can be disallowed, until recently, NASA did not have the authority to assess penalties. Legislation recently passed by the Congress provides civilian agencies, including NASA, with the authority to require their contractors to certify that all indirect costs included in their claims are allowable and to assess penalties when contractors claim expressly unallowable costs.²

Before this recent legislation, in situations where contractors holding both DOD and NASA contracts included expressly unallowable costs in their overhead claims, only the portion allocated to DOD was subject to penalty.³ For example, one contractor holding NASA and DOD contracts claimed expressly unallowable costs totaling \$212,000, including costs related to business interruption insurance, charitable donations, consulting, and travel in excess of amounts allowed by travel regulations. About \$82,000 of

²A penalty equal to the amount of the expressly unallowable costs plus interest is imposed in addition to repaying such costs. Where a submitted settlement proposal contains a cost determined to be unallowable before the proposal's submission, a penalty equal to twice the expressly unallowable costs is imposed. Penalties can be waived under certain conditions.

³DOD's penalty provision is found in 10 U.S.C. 2324.

these costs were not subject to penalty because they were allocated to NASA and another civilian agency.

In August 1992, an interagency team tasked by the Office of Management and Budget (OMB) to review NASA contracting practices and regulations disclosed several instances where NASA contractors did not identify and exclude unallowable costs from their government contract billings and claims.⁴ Some of these unallowable costs would have been subject to a penalty if the recently passed legislation had been in effect. According to DCAA field office personnel, some NASA contractors routinely claim unallowable costs. It is then up to the auditors to find and disallow them. But, as we reported in recent years, limited resources preclude DCAA from identifying all unallowable costs claimed by cost reimbursement contractors.⁵ Therefore, the full extent of unallowable costs claimed under NASA contracts is unknown.

In addition to requiring contractors to certify under penalty of perjury that indirect cost claims do not include unallowable costs and the prospect of paying an additional cost penalty, NASA could take other actions to deter its contractors from claiming unallowable costs. These include considering such claims during the award fee process or as part of contractors' past performance when awarding future contracts.

NASA's Use of DCAA Proposal Audit Support

NASA contract and pricing officials requested proposal pricing support from DCAA in appropriate circumstances and adequately considered DCAA's recommendations. However, contracting officers did not always document the status of contractor business systems in negotiation memorandums as required by the Federal Acquisition Regulation (FAR) and NASA FAR Supplement.⁶

⁴SWAT Team on Civilian Agency Contracting — Report on NASA (Aug. 1992). The team consisted of representatives from NASA headquarters, NASA's Office of Inspector General, OMB's Office of Federal Procurement Policy, and DCAA.

⁵Contract Pricing: Issues Related to DCAA Staff Levels (GAO/NSIAD-93-225, July 1, 1993); and Contract Pricing: Unallowable Costs Charged to Defense Contracts (GAO/NSIAD-93-79, Nov. 20, 1992).

⁶The prenegotiation position memorandum explains the contractor and government positions and ultimately becomes the basis for contract negotiations. The price negotiation memorandum documents the elements of the contract negotiated and the methodology and rationale used.

NASA Adequately Obtained and Used DCAA Pricing Support

In 25 procurement actions we reviewed, NASA contracting officers complied with FAR and NASA FAR Supplement requirements for requesting DCAA audits on contractor proposals or documented the reasons for not requesting audits. In the six cases where DCAA pricing services were not requested, contracting officials documented that other information was available to determine a reasonable price. Also, for the actions we reviewed where DCAA audit assistance was requested and received, NASA contracting officers almost always either adopted DCAA's recommendations when establishing the government's negotiating positions or adequately documented sufficient reasons for not accepting them.

Status of Contractors' Systems Not Properly Documented

The FAR and NASA FAR Supplement require that contracting officers address the status of contractor business systems in negotiation memorandums.⁷ Specifically, the NASA FAR Supplement requires that if systems do not apply to the procurement, the reasons for not discussing their status must be explained in negotiation memorandums. The adequacy of contractor systems is important in establishing negotiation objectives and in determining the extent of contract management oversight.

At the centers we visited, negotiation memorandums for over 70 percent (23 of 31) of the contracts we reviewed did not address the status or nonapplicability of the four systems specifically mentioned by the FAR—purchasing, accounting, estimating, and compensation. When systems were discussed, pertinent details as to who did the reviews and the date of the most recent review were frequently missing, as were reasons why some contracting officers determined the FAR requirement was not applicable to their negotiations. Also, rarely did memorandums address any other contractor systems that also might have affected negotiations or been pertinent to subsequent oversight.

NASA headquarters' procurement management surveys had previously noted noncompliance with this requirement at the two centers we visited. Our review of 12 procurements awarded after headquarters' reviews showed that, while compliance increased, the status of all systems, or reasons for their nonapplicability, was still not always addressed. According to a headquarters' procurement official, NASA will revise its form

⁷The FAR lists four contractor business systems as examples that might affect negotiations (i.e., purchasing, accounting, estimating, and compensation). However, there is no guidance on which other contractor internal control systems also might affect negotiations. Such systems that could affect negotiations and subsequent contract oversight include billing, pension and insurance, budget and planning, government property, and material management and accounting systems.

for requesting DCAA audit services to ask DCAA to comment on the current status of all contractor systems that could affect contract negotiations.

The centers we visited have already begun to tailor their audit requests to require that DCAA address the status of contractor systems. Both centers have also developed a checklist to assist contracting personnel in preparing for negotiations that include the requirement to address the status of contractor systems. One center issued a notice to all contracting personnel reminding them of the documentation requirements. The other center is developing a centerwide database of contractor business systems and hopes to implement the system within the next year.

According to one center's procurement managers, although the status of systems was not always documented as required, the information is requested from contractors and verified with DCAA. However, some contracting officers told us they assumed contractor systems were approved and current, and they did not verify their status with DCAA. Documenting their status in negotiation memorandums can help ensure that contracting officials adequately consider contractor systems in negotiations.

NASA Needs to Be More Involved in Audit Planning

NASA and DCAA have increased their coordination and improved their working relations over the years. For example, at one center, DCAA recently established an audit liaison to respond to NASA concerns and issues. However, NASA procurement officials were not actively involved in planning what DCAA audits would be done and were generally unaware of DCAA's audit coverage of their contractors and contracts. Consequently, they did not know about some areas that may require additional audit coverage and could not consider alternative ways to obtain such coverage. NASA's Office of Inspector General is working to improve NASA's involvement in audit planning and monitoring of audit activity.

NASA Not Routinely Involved in Audit Planning

NASA generally relied on DCAA and DOD administrative contracting officers to plan post-award audits, and NASA contracting officers were generally unaware of DCAA's audit plans and schedules.⁸ Contracting officers told us they periodically requested special audits when they suspected problems, but did not typically get involved in audit planning or assessing if additional audit coverage was needed. They told us DCAA knows best what

⁸NASA contracting officers delegate most contract administration functions to other agencies—primarily DOD's—contract administration offices. Such functions often include working with DCAA.

audits to conduct and when to conduct them and that they were unaware of contract audit requirements. In several instances, contracting officers told us they did not know the status of their contractors' business systems, when the systems were last reviewed, or whether audit coverage was complete.

NASA procurement managers also did not systematically assess whether audit coverage was complete or if additional audits were needed. At one center, procurement officials met periodically with DCAA audit managers to discuss ongoing reviews and future audit plans. However, discussions did not include the audit coverage on individual contractors or the need for additional coverage. At the other center, procurement officials have historically provided little contractor-specific input to the annual request for issues requiring DCAA audits.

Some Areas Require Increased Audit Coverage

Data collected by NASA's Inspector General over the past 2 years showed that DCAA did not always audit NASA's larger contractors on a timely basis and that some areas required additional audit coverage. Due to DCAA and NASA audit priorities and limited resources, annual audits, including incurred cost audits, and periodic business system reviews were not always done when required. Also, few operational or functional reviews were done, even though DCAA experience has shown that such reviews help improve contractor efficiencies and decrease government contract costs. According to DCAA headquarters' officials, DCAA would provide additional audit resources and coverage if NASA requested the reviews and provided more funds.

According to NASA headquarters' Inspector General officials, field inspector general staffs should work with center procurement managers and contracting officers to discuss NASA audit priorities, including areas requiring additional audit coverage. Center officials should then meet with DCAA to provide contractor-specific input into DCAA audit plans. However, center procurement managers and contracting officers told us they were unaware of the results of these Inspector General efforts.

Since NASA is ultimately responsible for managing its contracts, it should maintain better oversight of contract audit activities and be more involved in planning audit coverage and setting priorities. More active involvement could result in better coordination with DCAA auditors and DOD administrative contracting officers, more effective use of DCAA resources, and an opportunity for NASA to determine if additional DCAA resources are

needed. If these efforts indicate DCAA's inability to provide audit coverage despite NASA's willingness to pay, NASA could consider alternatives, such as using NASA pricing analysts in lieu of DCAA auditors to do proposal pricing analyses, having NASA Inspector General staff conduct contractor operational or functional reviews, and engaging qualified public accounting firms to do specified audits.

NASA Audit Follow-up Should Be More Comprehensive and Timely

NASA did not comply with OMB and other guidance on audit report tracking and follow-up. Both NASA headquarters and center audit follow-up systems were incomplete, which could preclude agency officials from ensuring that significant audit issues are properly resolved. Further, NASA contracting officers often did not make timely resolution decisions on contract audit report recommendations. NASA also did not consistently oversee and document DOD's resolution of audit findings on those contracts where NASA had delegated authority to DOD.

NASA Audit Follow-up Efforts Were Incomplete

OMB Circular A-50, "Audit Follow-up," sets governmentwide policy on responding to contract audit findings and recommendations. OMB requires agencies to, among other things, (1) track all audit reports to ensure that findings and recommendations are properly resolved and corrective actions taken, (2) report semiannually to agency administrators on the status of unresolved audit reports over 6 months old,⁹ and (3) periodically evaluate the follow-up system's operations. NASA was not fully complying with these requirements.

NASA headquarters and center tracking systems did not contain all reports requiring NASA officials to take corrective actions. NASA headquarters' tracking system did not include all audit reports referred by DCAA as reportable. Of the 32 new audit reports referred to NASA by DCAA during fiscal year 1993, 9 were not in NASA headquarters' tracking system or listed in its semiannual report to the NASA Administrator. For example, an August 1993 report that questioned about \$224,000 in defective pricing was not tracked.

NASA did not track and report these "reportable" audits because complete reconciliations between the headquarters' tracking system database,

⁹NASA is required to report audits with significant unresolved findings to the NASA Administrator. According to the NASA Audit Follow-up Handbook (NHB 9970.2), reportable audit reports include (1) expenditure audits that contain findings and recommendations totaling \$100,000 or more and (2) all business system reviews.

center databases, and DCAA referrals had not been done.¹⁰ Headquarters' policy was to not report these audits until the centers confirmed that the reports were properly addressed to NASA for follow-up action. However, five of these missing reports had been issued in 1992 and should have been either reported or referred to DOD for tracking.

In response to our request in July 1994, NASA headquarters followed up on the nine missing reports and found that four of them should have been tracked by NASA headquarters and included in its semiannual report; three had already been closed or were in the process of being closed; and two were incorrectly referred by DCAA as reportable audit reports. Center tracking systems were also incomplete. One center's tracking system only included reportable audits, although other audits required contracting officer attention and center procedures required that all system and expenditure audits be tracked. The center's audit follow-up official questioned the benefit of centrally tracking nonreportable audit reports and said such reports are tracked by individual contracting officers and to a small extent by the Inspector General. However, central tracking of all post-award contract audit reports requiring NASA action would help ensure appropriate management oversight and timely resolution of issues affecting NASA contracts.

Another center's system tracked both reportable and nonreportable audits but, based on our limited review, nine reports that required contracting officer action were missing from the tracking system. For example, one missing report dated October 1993 questioned about \$80,000 of the claimed costs on two cost reimbursement contracts and noted that the contractor had claimed over \$198,000 in unallowable costs since the inception of the two contracts. Another missing report dated April 1993 questioned \$494,500 of claimed costs as being defectively priced. The center audit follow-up official said that the missing reports should have been tracked and added them to the system. The official said the reports would have been tracked had cognizant contracting officers notified him of the reports. As a result of our review, the center's Director of Procurement issued a notice on procedures for tracking contract audit reports and resolving audit recommendations.

¹⁰Under this system, DCAA field auditors refer reports meeting the reportable audit criteria to NASA for resolution by attaching an audit follow-up sheet to the original copy of the audit report. DCAA also sends copies of these sheets monthly and summary lists of referred audit reports semiannually to the NASA headquarters' follow-up official for reconciliation. This reconciliation process is meant to ensure the comprehensive identification and timely resolution of significant audit issues for which NASA has resolution responsibility. Beginning in late 1994, DCAA headquarters plans to provide NASA with a monthly list of reportable contract audit reports.

According to NASA headquarters' procurement officials, the adequacy of each center's contract audit follow-up system is supposed to be reviewed during headquarters' procurement management surveys. However, recent surveys at the centers we visited did not assess whether all appropriate reports were being tracked. According to headquarters' officials, NASA's procurement survey guide will be modified to include an evaluation of center procedures for identifying and tracking audit reports.

Timely Action Not Taken on Some Audit Reports

OMB Circular A-50, NASA's FAR Supplement, and the NASA Audit Follow-up Handbook require contracting officers and procurement officials to pursue timely management resolution and disposition of contract audit reports.¹¹ Work recently concluded by NASA's Inspector General showed that NASA procurement officials did not aggressively pursue the resolution of audit reports and frequently did not meet requirements for resolving audit recommendations within 6 months after the audit report was issued.

In a May 1994 report, NASA's Inspector General found that 53 percent of the audit reports sampled did not meet the 6-month resolution requirement, with some taking as much as 30 months to resolve.¹² In the Inspector General's opinion, 48 percent of the reports exceeding the resolution requirement could have been resolved and corrective actions could have been taken more promptly. Delays were attributed to insufficient oversight and emphasis by higher level headquarters and center acquisition officials, and center procurement officials did not have clear and formal performance standards to provide effective contract audit follow up.

In its response to the Inspector General's report, NASA's Office of Procurement agreed to more closely monitor center contracting officer timeliness in resolving audit report findings, revise the headquarters' procurement survey guide to include specific steps for evaluating contract audit follow-up in future procurement reviews, and include standards for audit follow-up in contracting officers' performance plans.

¹¹OMB and NASA require resolution of post-award audits within 6 months of report issuance and disposition as soon as possible after resolution. Resolution occurs when the audit resolution official—either the procurement contracting officer or the administrative contracting officer—in consultation with the auditor, decides on the appropriate action to take. Disposition occurs when the contractor implements the audit recommendation or the contracting officer's decision.

¹²NASA Audit Follow-up Process: Headquarters Center (HQ-94-009, May 26, 1994).

NASA Not Adequately Monitoring Audits to Be Resolved by DOD

NASA contracting officers generally did not monitor the status of DCAA audit reports sent to DOD for follow-up, did not always document the resolution of such reports in contract files, and were often unaware of DOD actions that affected their contracts.¹³ Consequently, NASA could not ensure that audit findings and recommendations were resolved on a timely basis and that the resolutions were in NASA's best interest. NASA's contract audit follow-up systems also do not track the status of audit reports DOD is responsible for resolving.¹⁴

In certain cases, some monitoring of actions taken by DOD was being done. For example, at one center, two procurement branches tracked all DCAA reports affecting their contracts, including those for which DOD held resolution responsibility. Contracting officers in these two branches said that tracking such reports improves their oversight of contractor operations. Also, center Inspector General staffs require center procurement officials to follow up on a small number of reports that were sent to DOD for resolution.¹⁵

Although NASA's policy is to optimize the use of contract administration services of other government agencies, this does not relieve NASA contracting officers of their oversight responsibilities. Increased monitoring of DOD's audit resolution activities would allow NASA to (1) determine the current status of all significant unresolved audits, (2) judge the appropriateness of the audit resolution actions taken by DOD personnel, and (3) better understand the quality of their contractors' business operations.

Delays in Closing Contracts Need to Be Addressed

NASA has not met FAR guidelines on closing out physically completed contracts.¹⁶ As of December 1993, NASA had over 2,600 contracts awaiting closeout, some of which related to work completed in the late 1970s and early 1980s. Of these, 70 percent of the 449 fixed-price contracts, 57 percent of the 2,115 contracts requiring settlement of indirect cost

¹³NASA contracting officers often delegate the resolution of audit findings on NASA contractors to DOD administrative contracting officers.

¹⁴These reports should be tracked on DOD systems.

¹⁵According to DCAA's Contract Audit Manual, NASA centers' Inspector General staff should receive copies of audit reports on contractors located in their geographic area. Center Inspector General staffs review these reports for significant impact on NASA.

¹⁶FAR guidelines for closing out physically completed contracts are 6 months for fixed-price contracts and 36 months for cost-reimbursement contracts.

rates, and 9 percent of all other contracts exceeded the FAR guidelines for closeout.

Excessive delays were due to a variety of reasons, including NASA placing a low priority on closing contracts; DCAA's backlog in completing audits of contractor- and subcontractor-incurred costs; contractors placing low priority on submitting required closing documentation; and contracts being litigated or under criminal investigation. DCAA has established an initiative to prioritize audits in an effort to reduce the large backlog of completed contracts to be closed.

Excessively delaying contract closeout is not a good business practice because it increases the government's exposure to contractors' financial and internal control problems, delays corrective actions needed to prevent contractors from billing excessive costs, and increases the government's risk that contractors owing money may go out of business or lose records. Also, contractors may use unaudited historical data containing unallowable costs in negotiating future fixed-price contracts with the government and may gain interest-free use of government funds if overpayments were made. Delaying contract closeout also increases the risk of using current year funds to pay for prior year obligations and requires government financial management personnel to perform additional work to avoid losing expiring funds.

Although NASA headquarters' procurement management survey guidelines cover contract closeout, delays were not mentioned in 1993 survey reports for the centers we visited. NASA has not reviewed closeout delays agencywide and relies on its centers to address closeout issues. NASA has emphasized using "quick closeout" procedures, but very few contracts had been closed using this method at the centers we visited.¹⁷

Recommendations to the NASA Administrator

We recommend that the NASA Administrator do the following:

- Develop, test, and implement initiatives to help deter NASA contractors from claiming unallowable costs, such as considering prior unallowable cost claims as part of contractors' past performance when awarding future contracts. These initiatives would be in addition to the recently passed legislation on certification and penalty provisions.

¹⁷Quick closeout procedures may be used on a contract that is physically completed; has unsettled indirect costs of \$500,000 or less; and has a value, excluding fee, of \$2 million or less.

- Re-emphasize the requirement that contracting officers document the status or nonapplicability of all contractor business systems in negotiation memorandum, including those not specifically mentioned as examples in the FAR.
- Coordinate with the NASA Inspector General, and DOD administrative contracting officers where applicable, annually assess and prioritize audit coverage of NASA contractors and provide contractor-specific input to DCAA's audit planning process. If necessary, develop and consider alternatives or strategies to achieve more complete and timely contract audits.
- Track and follow up on contract audit reports in the timely and comprehensive manner required by OMB Circular A-50.
- Monitor audit findings and recommendations that could affect NASA contracts that are resolved by DOD administrative contracting officers and document their status and disposition in contract files.
- Develop, test, and implement initiatives to reduce existing backlogs of delinquent physically completed but unclosed contracts, and direct NASA personnel to periodically report to senior management on the results of these initiatives.

Agency Comments and Our Evaluation

DOD's and NASA's comments are included in appendixes III and IV. DOD concurred with the report. NASA generally agreed with it but offered several comments on our findings and recommendations.

NASA agreed that certification and penalty provisions would be effective tools for deterring contractors from claiming unallowable costs. However, it noted that the alternatives we offered—considering prior unallowable cost claims during the award fee process and as part of the contractor's past performance when awarding future contracts—would be less effective and would not provide sufficient incentives for contractors to ensure all unallowable costs are excluded from overhead claims. We did not intend such actions as substitutes for a penalty. Rather, such actions represent additional ways to deter contractors from claiming unallowable costs. Our intention is that they be considered in addition to any applicable penalty, and we clarified our recommendation accordingly.

NASA agreed that it needs to become more involved in DCAA's audit planning process but noted that it is DCAA's role, as the government's prime audit representative, to perform audit planning functions and consider the needs of all of its customers, including NASA. Although DCAA is responsible for developing its own audit plan, NASA is responsible for managing its

contracts. Therefore, NASA has responsibility for ensuring that its contractors receive appropriate audit coverage and, where necessary, using alternative means to achieve such coverage when DCAA cannot provide it.


NASA agreed that its audit tracking and reporting systems need improving. However, NASA expressed concern that we were recommending that its contract audit follow-up systems track the status of audit reports that DOD also tracks and is responsible for resolving. We do not want NASA to duplicate DOD's work. Our point is that NASA should understand and evaluate the adequacy of the service it is receiving in this area. That is what we mean when we recommend that NASA "monitor" audit resolution and document its status and resolution in contract files.

Other NASA comments have been incorporated throughout the report where appropriate or addressed at the end of appendix III.

The scope and methodology of our work is described in appendix I. Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies of this report to other appropriate congressional committees; the NASA Administrator; and the Director, OMB. We will also provide copies to others upon request.

Please contact me on (202) 512-8412 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix V.

Sincerely yours,



Donna M. Heivilin
Director, Defense Management
and NASA Issues

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Abbreviations

DCAA	Defense Contract Audit Agency
DOD	Department of Defense
FAR	Federal Acquisition Regulation
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget

Scope and Methodology

To identify unallowable costs claimed on National Aeronautics and Space Administration (NASA) contracts, we reviewed Defense Contract Audit Agency (DCAA) reports, NASA and Department of Defense (DOD) regulations, and legislation regarding certification and penalty provisions. We interviewed DCAA and NASA officials to address the significance of unallowable cost claims and to determine the deterrents available or needed to reduce such claims.

To test compliance with the Federal Acquisition Regulation (FAR) and NASA FAR Supplement requirements for obtaining pre-award pricing support and using DCAA recommendations, we judgmentally selected 7 fixed-price and 18 cost-reimbursement procurement actions valued at between \$515,000 and \$481 million. We reviewed DCAA proposal audit reports and NASA pricing reports and negotiation memorandums, and interviewed cognizant procurement personnel. We judgmentally selected and reviewed negotiation memorandums for 31 procurement actions to determine if NASA adequately documented the status of contractor business systems.

To assess NASA's involvement in planning contract audits and in determining if additional audit coverage was needed, we interviewed NASA headquarters, center procurement, NASA Inspector General, and DCAA officials. We also reviewed NASA contract files, DCAA's Contract Audit Manual, and the Inspector General's analysis of DCAA audits on NASA's top 25 contractors.

To assess NASA's compliance with Office of Management and Budget (OMB) Circular A-50, the NASA FAR Supplement, and other guidelines on audit tracking and follow-up, we interviewed NASA headquarters and center procurement officials about their procedures and review activities. We compared reports on NASA headquarters' audit follow-up system to those on lists generated by DCAA and compared center systems to reports received by center Inspector General staffs. We did not evaluate NASA's compliance with FAR timeliness requirements for resolving DCAA report recommendations since the NASA Inspector General recently reviewed this issue. Results of the Inspector General's audit are included in this report.

To assess NASA's contract closeout activities, we obtained summary reports from NASA headquarters and detailed reports from centers on the status of physically complete contracts that were not closed. We discussed reasons and potential impacts of delays with contract closeout, procurement, financial management, DCAA, and contractor officials. We also reviewed closeout files for 12 contracts that were physically

completed between August 1982 and January 1988 but not closed out as of November 1993.

We conducted our audit work at NASA and DCAA headquarters, two NASA field centers (Johnson Space Center in Houston, Texas, and Goddard Space Flight Center in Greenbelt, Maryland), and two DCAA field audit offices. We conducted our work between May 1993 and July 1994 in accordance with generally accepted government auditing standards.

Examples of Unallowable Costs Claimed on NASA Contracts

DCAA found the following examples of unallowable costs in claims made by NASA contractors in recent years. For the costs DCAA determined to be expressly unallowable, the portion allocated to NASA contracts may have been subject to unallowable cost penalties if DOD had awarded the contract.

- An officer's personal auto expenses of \$2,487 described as salary expense; \$3,581 for rental of a personal residence for other than government business; \$4,000 in lobbying costs, \$5,516 in entertainment costs; and, over a 2-year period, \$98,047 in unapproved deferred compensation.
- Travel expenses of \$10,296 in excess of amounts allowed by travel regulations; \$41,632 for unsupported public relations costs; \$1,774 for penalties; \$1,910 for gifts and donations; unapproved bonuses of \$11,200 to employees; \$3,000 in bank fees related to lines of credit; \$7,224 for bad debt expenses; \$4,943 in management and legal fees, including personal legal fees for marital matters; \$12,380 in cost overruns on other contracts; and \$20,000 in severance pay to an employee who resigned.
- Bank charges of \$28,238 for maintaining insufficient funds, \$41,516 in overstated depreciation charges, \$45,465 in overstated medical insurance costs, \$12,537 in overstated profit sharing costs, and \$86,588 in unallowable life insurance benefits.
- Over a 3-year period, legal fees and settlements of \$9,815 incurred in commercial contract and federal income tax disputes; \$30,858 for federal income taxes and penalties; \$3,065 for charitable contributions; \$1,461 for social activities; \$47,824 in interest expenses; and \$49,691 in unallowable bonuses to the owner/president.
- Entertainment expenses of \$16,162 while traveling in Mexico, France, and elsewhere; \$9,873 for maintaining a ski resort condominium used solely for entertainment purposes; \$47,815 for executive fringe benefits while engaged in expressly unallowable entertainment activities; lease costs for a luxury vehicle of \$9,060 in excess of what the contractor had agreed to in the prior year; \$14,443 in legal fees unrelated to the contract; unallowable distribution of profits of \$136,000 to key officers; and \$53,816 in officers' salaries when engaged in unallowable entertainment activities.
- Retroactively revising the useful lives of assets, thus overstating depreciation costs by over \$1.5 million—about 15 percent of total depreciation costs claimed—and travel expenses of \$14,650 in excess of amounts allowed by travel regulations and for spouses to accompany employees on business trips.
- Contributions of \$10,269, entertainment costs of \$66,866, alcoholic beverage costs of \$41,068, and \$7,405 in excess travel costs.

Appendix II
Examples of Unallowable Costs Claimed on
NASA Contracts

- Unallowable travel costs of \$57,076 over a 3-year period. All claimed costs were questioned because the contractor refused to provide supporting documentation after the auditor identified significant irregularities during an initial review of selected sample items. The contractor also claimed a security deposit of \$9,841 as rental expense.
- Alcohol and unreasonable entertainment costs totaling \$13,445 and a payment of \$100,000 to settle a lawsuit brought by a former employee who alleged retribution for disclosure of information suggesting the contractor was violating safety and other regulations during performance under a space shuttle contract.
- Business interruption insurance of \$15,592, donations of \$50,197, lobbying costs of \$6,378, entertainment costs of \$49,255, and travel costs over amounts allowed by travel regulations and other unsupported travel costs of \$139,853.
- Travel costs over amounts permitted by government travel regulations and other unallowable costs totaling \$25,252. While penalties were assessed on the unallowable costs allocated to seven DOD contracts, the portion allocated to a NASA contract was not subject to penalty.
- Marketing costs, including the costs of exhibits and conventions, and entertainment, totaling \$24,344.

Comments From the National Aeronautics and Space Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

National Aeronautics and
Space Administration
Office of the Administrator
Washington, DC 20546-0001



Mr. Frank C. Conahan
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

Thank you for the opportunity to comment on your draft report "NASA CONTRACT MANAGEMENT - Improving the Use of DCAA's Auditing Services." We have reviewed the draft report and generally agree with its contents. We do, however, offer the following comments regarding your findings and recommendations.

GENERAL COMMENTS - We have a concern that the report, as drafted, would leave readers with the impression that NASA has paid contractors significant amounts of unallowable costs. From our discussions with the evaluator-in-charge, we understand that the findings are limited to the fact that contractors included unallowable expenses in their final overhead claims. The instances cited in the body of the report and in appendix III were all identified by DCAA during their audits and would thus be deleted by Government representatives during the rate negotiation process. We recommend that the language of the report be clarified to indicate that contractors were not reimbursed for these unallowable costs by NASA and that the system has been working to identify and exclude unallowable expenses.

PENALTIES ARE NEEDED TO DETER NASA CONTRACTORS' UNALLOWABLE COST CLAIMS - This section of the report addresses unallowable costs that NASA contractors have no deterrent from claiming. We strongly support the initiative in Congress to add a certification and penalty provision for civilian Agency contractors similar to the one with which DOD contractors must comply. We believe the alternatives offered in your report would be less effective and would not provide sufficient incentives for contractors to ensure all unallowable costs are excluded from their overhead claims.

NASA'S USE OF DCAA PROPOSAL AUDIT SUPPORT - This section addresses the use of DCAA pricing support and the documentation of contractor system status in negotiation memorandums. We are in total agreement with your finding that contractor business systems must be considered and addressed in negotiation memorandums and have made this point a specific topic of review during our procurement surveys of Center procurement offices. We do question whether this issue is appropriately addressed in an audit that is reviewing use of DCAA services. The majority of

See comment 1.

Appendix III
Comments From the National Aeronautics
and Space Administration

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contractor systems that we are concerned with (including purchasing, property management, quality, estimating, compensation, material management and accounting, and pension and insurance) would fall under the purview of the Administrative Contracting Officer (ACO) responsible for any particular contractor. Although DCAA assistance would normally be obtained by that individual in the process of system review and approval, the final call, with the exception of the accounting system, would be the responsibility of the ACO. It is preferable to obtain the information directly from the ACO (in most cases a DCNC employee) than rely on a summarization contained in the DCAA report. We recommend that the issue, if retained in this report, comment only on the need to address system status and not focus on the source of the information.

The footnote (No. 7), at the bottom of page 7, states that "NASA has not developed guidance on which other contractor internal control systems also might affect negotiations." We believe any elaboration, as to what specific systems should be addressed, should be included in the FAR to ensure consistent application in all Agencies.

NASA NEEDS TO BE MORE INVOLVED IN AUDIT PLANNING - This section addresses the need for NASA to become more involved in DCAA's audit planning. We concur with this general finding and have agreed with DCAA to devote part of our upcoming Procurement Officer's Conference to a meeting with DCAA Field Area Office representatives. We believe these discussions will help improve the audit planning process by enhancing communications between our respective offices. We also encourage our procurement offices to maintain an ongoing dialogue with the DCAA offices that have been delegated functions on their contracts.

We believe, however, your goal of improving audit coverage for any specific contractor location would be better accomplished if your recommendation was addressed from a different perspective. At many contractor locations, NASA is but one of a number of Agencies doing business. It is appropriate for one party to take a broad overview of the total Government activity at that location and make necessary judgements as to what type of audit coverage is required. We believe it is DCAA's role, as the Government's prime audit representative, to perform this function and make these decisions. The yearly audit plan is a DCAA internal process during which DCAA needs to solicit and consider the needs of its customers, such as NASA. The emphasis for change must come from both directions, internally from within DCAA, and externally from all of its customers--not just NASA. We recommend that the focus of this finding be redirected.

NASA'S AUDIT FOLLOWUP SHOULD BE MORE COMPREHENSIVE AND TIMELY - This section identified several deficiencies in the audit followup and tracking systems required to comply with OMB

See comment 2.

Appendix III
Comments From the National Aeronautics
and Space Administration

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Circular A-50, "Audit Followup." We concur with the general need to improve our tracking and reporting systems and have, as was noted in the draft report, recently taken actions in response to a NASA OIG report. These actions will help to ensure that required audits are appropriately tracked and that milestones for resolution of audit recommendations are met.

We are concerned, however, with your comments on page 16 that appear to recommend NASA contract audit followup systems track the status of audit reports that DOD has responsibility for resolving. We strongly endorse the need for NASA's contracting officers to maintain an ongoing dialogue with DOD Administrative Contracting Officers (ACO's) who have been delegated, or have FAR mandated, administrative responsibilities with our contractors. We do not believe it is practical or cost effective, however, to have our personnel involved in a process of overseeing their DOD counterparts workload on all reportable audits. Many of these audits, such as those involving Cost Accounting Standards, contractor system reviews, and final indirect cost rates, are the responsibility of the DOD ACO with or without a NASA delegation. We agree that we should understand what is going on in our contractor's facilities and how well they are performing; however, we believe there are better ways to gain this information than the manner you propose. Finally, having DOD reports tracked in two reporting systems also invites the possibility of double counting audits in the final Agency reports to Congress. We strongly suggest that this recommendation be deleted.

DELAYS IN CLOSING CONTRACTS NEED TO BE ADDRESSED - This section addresses the need for NASA to improve its performance in closing out physically completed contracts. We concur with the need for improvement and are working to streamline the closeout process through automation and improved policies and procedures. These actions will enable us to make maximum use of existing, limited resources. In addition, we have worked with DCAA to identify contractor locations where the lack of audited final overhead rates constrained closeout of physically completed contracts and used this information to prioritize incurred cost audits by DCAA.

Again, we appreciate the opportunity to comment on your report.

Sincerely,


R. Dailey
Associate Deputy Administrator

The following are GAO's comments on NASA's letter dated September 20, 1994.

GAO Comments

1. We believe that the report clearly indicates the process through which NASA or other government representatives can disallow unallowable costs identified during audits. Also, we only partly agree with NASA's statement that "the system has been working to identify and exclude unallowable expenses." While the system finds unallowable costs such as those described in this report, limited audit resources preclude DCAA from assuring that all unallowable costs claimed by contractors are identified. Work by NASA, DCAA, and GAO show that, although the full extent of the problem remains unknown, NASA contractors continue to make unallowable cost claims. Therefore, auditors must detect them in order to disallow them.
2. As NASA stated, this information can be obtained from administrative contracting officers, as well as DCAA. We did not intend to focus on only one source of information about the status of contractors' systems. However, DCAA has a significant role in reviewing and commenting on the status of several of the systems included in our review, including estimating, accounting, and compensation.

Comments From the Department of Defense



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

SEP 9 1994

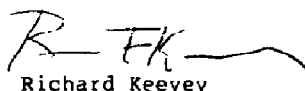
Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report GAO/NSIAD-94-229, "NASA CONTRACT MANAGEMENT: Improving the Use of DCAA's Auditing Services," dated August 23, 1994 (GAO Code 709016/OSD Case 9727).

The DoD has reviewed the draft report and concurs without further comment. The Department appreciates the opportunity to review the report in draft form.

Sincerely,


Richard Keevey
Deputy Comptroller
(Financial Systems)

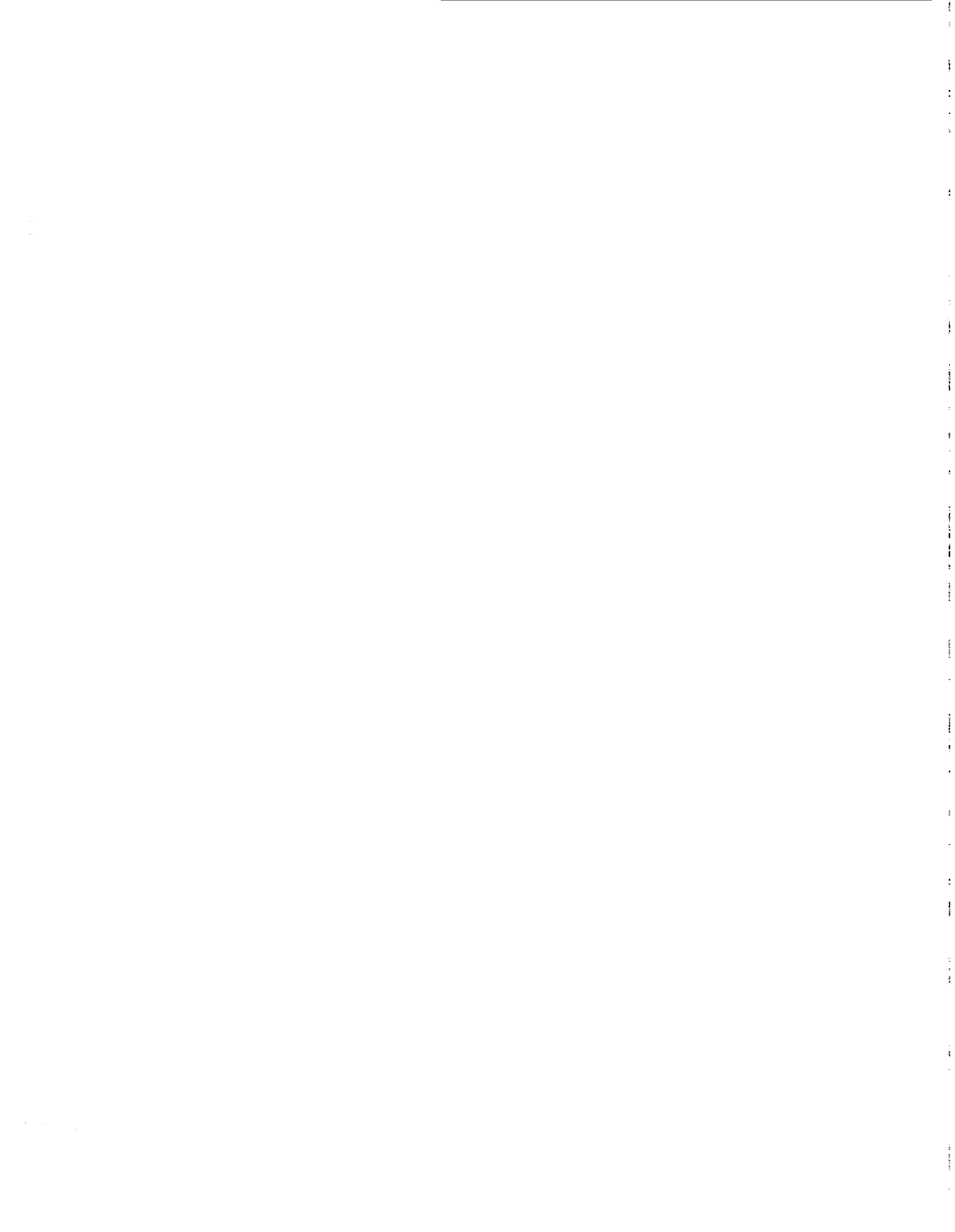
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