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Highlights

DEFENSE CONTRACTING

DOD Initiative to Address Audit Backlog Shows Promise, but Additional Management Attention Needed to Close Aging Contracts

Why GAO Did This Study

DOD has a large volume of contracts that have not been closed on time. Closing a contract includes tasks such as verifying that the goods and services were provided and making final payment to the contractor. Closing contracts within required time frames can limit the government's exposure to certain financial risks. One reason why some contracts are not being closed is the large backlog of incurred cost audits that must first be completed. These audits, conducted by DCAA, ensure that the costs contractors have incurred are permissible under government regulations.

The Senate Armed Services Committee report accompanying the National Defense Authorization Act for Fiscal Year 2012 directed GAO to review the criteria and procedures for conducting incurred cost audits, among other things. In response, GAO assessed (1) efforts to reduce the backlog of incurred cost audits and (2) the challenges DOD faces in addressing the contract closeout backlog. GAO reviewed DCAA's policies and procedures for incurred cost audits; analyzed data on the audit and contract closeout backlogs; and interviewed officials in the military departments and agencies.

What GAO Recommends

GAO is recommending that DCAA develop a plan to assess its incurred cost audit initiative; that DCMA improve data on over-age contracts; and that the military departments develop contract closeout data and establish performance measures. DOD concurred with the recommendations and identified ongoing and planned actions to address them.

What GAO Found

To reduce the backlog of incurred cost audits, the Defense Contract Audit Agency (DCAA) implemented an initiative to focus its resources on auditing contractors' incurred costs that involve high dollar values or are otherwise determined to be high risk. Incurred cost audits are conducted on a contractor's annual proposal that includes all costs incurred on certain types of contracts in that fiscal year. Under the initiative, DCAA raised the dollar threshold that triggers an automatic audit on a contractor's incurred cost proposal from $15 million to $250 million, revised the criteria used to determine a proposal's risk level, and significantly reduced the number of low risk audits that will be randomly sampled. This initiative appears promising, and DCAA plans to track certain characteristics, such as the number of risk determinations made and audits completed. But DCAA has not fully developed the measures by which it will assess whether the initiative reduces the backlog in a manner that protects the taxpayers' interests. Specifically, DCAA does not have a plan for how it will determine whether key features of the initiative, such as the revised risk criteria and the revised sampling percentages, should be adjusted in the future. By 2016, DCAA estimates it will reduce the backlog and reach a steady state of audits, which it defines as two fiscal years of proposals awaiting review. DCAA's ability to achieve this goal will depend on a number of factors, including the number of proposals determined to be high risk, which as of September 2012 was about two-and-a-half times more than anticipated.

Reducing the backlog of incurred cost audits will ease one obstacle to closing over-age contracts, but other obstacles, such as limited data and performance metrics, must still be overcome. The military departments have limited data on the extent and nature of their contract closeout backlog, and the Defense Contract Management Agency (DCMA)—which performs contract administration services for the Department of Defense (DOD)—is missing information that would allow it to identify contracts that it could act on. Such data can cue agencies on how to identify or tailor approaches to address the backlog. Further, the military departments generally do not have performance metrics to measure progress in closing out contracts. The Army recently announced a goal of closing over 475,000 contracts by September 2014; however, it does not yet have the information necessary to know if it can reach this goal and does not have an implementation plan. The Navy and the Air Force had not established any department-wide performance metrics for contract closeout. In contrast, DCMA has established two agency-wide performance metrics related to contract closeout that are regularly monitored. While many officials said contract closeout was not a priority, GAO found some local contracting activities taking action to bring attention to contract closeout.

_____ **United States Government Accountability Office**