

**MORE INCURRED-COST AUDITS OF DOT
PROCUREMENT CONTRACTS SHOULD
BE OBTAINED**

Office of the Secretary

*Report Number: FI-2007-064
Date Issued: August 29, 2007*



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** More Incurred-Cost Audits of DOT
Procurement Contracts Should Be Obtained
Report Number FI-2007-064

Date: August 29, 2007

From: Mark H. Zabarsky *Mark H. Zabarsky*
Deputy Assistant Inspector General for
Financial Management Audits

Reply to
Attn. of: JA-20

To: Assistant Secretary for Administration

This report presents the results of our audit concerning the use of incurred-cost audit services on Department of Transportation (DOT) procurement contracts. It does not include the Federal Aviation Administration's (FAA) use of contract audit services. A report on FAA's use of audit services was issued in May 2002.¹

Annually, DOT spends about \$6 billion in procuring goods and services to support departmental operations—about \$2 billion if FAA is excluded. An efficient and effective contract management and administration program considers the use of contract audits to ensure that claimed contractor costs are accurate and allowable. Contract audits are necessary throughout a contract's life cycle. For example, incurred-cost audits determine whether costs charged to Government contracts are allowable, allocable, and reasonable, in accordance with contract terms and applicable Government acquisition regulations.

Like most Federal agencies, DOT primarily uses the Defense Contract Audit Agency (DCAA) to perform incurred-cost audits of contractors. DCAA's work has shown many instances in which Federal Government agencies were overbilled or the amounts paid, claimed, or both were questionable. In fiscal year (FY) 2006, DCAA reported about \$2.3 billion in net savings to the Federal Government as a result of all contract audits.

The objectives of the audit were to determine whether DOT and its Operating Administrations were (1) obtaining contract audit services in accordance with

¹ "Report on Oversight of Cost Reimbursable Contracts," May 8, 2002, OIG Report Number FI-2002-092. Most OIG reports can be accessed on our website: www.oig.dot.gov.

policies, procedures, and acquisition regulations and (2) effectively using audit results to recover overpayments to contractors. This audit was performed in accordance with Generally Accepted Government Auditing Standards as prescribed by the Comptroller General of the United States. Our scope and methodology are described further in Exhibit A.

BACKGROUND

To strengthen oversight of agency acquisition activities, Congress enacted the Services Acquisition Reform Act of 2003, which established Chief Acquisition Officers at Federal agencies. The Chief Acquisition Officer is responsible, in part, for monitoring the performance of acquisition activities and programs of the Department and evaluating the performance of those programs. The Senior Procurement Executive is responsible for direction of the procurement system of the Department, including implementation of unique procurement policies, regulations, and standards. In DOT, the Deputy Secretary is the designated Chief Acquisition Officer, who has delegated the day-to-day operations to the Senior Procurement Executive in the Office of the Secretary. The Senior Procurement Executive reports directly to the Assistant Secretary for Administration.

RESULTS IN BRIEF

Since 2005, departmental officials have emphasized incurred-cost audits and have achieved success with them, recovering a high percentage of contractor overpayments. Specifically, the Assistant Secretary for Administration issued a memorandum in November 2005 to increase awareness and address the importance of incurred-cost audits; the Senior Procurement Executive has begun implementing a new approach for obtaining these audits; and the Department has achieved considerable cost savings through incurred-cost audits, recovering over \$4 for every audit dollar DOT spent for these audits.

More, however, needs to be done. Use of cost-reimbursable contracts increases the Government's risk because contractors generally have little incentive to control costs. In reviewing 30 cost-reimbursable contracts to assess the extent to which audits were obtained and used to administer these contracts, we found that Operating Administration contracting offices:

- Obtained incurred-cost audits on 12 of the 30 contracts, having a total value of more than \$640 million. For the remaining 18 contracts, audits were not obtained and the required justification for not obtaining them was not provided for 17 of the 18. These 18 contracts represented a value of more than \$600 million.

- Resolved questioned costs of about \$600,000 that DCAA identified for 3 of the 12 audited contracts. However, for 6 of the 12, contracting officers took no action to resolve questioned costs of \$1 million. No action was required for the remaining three contracts.

Exhibit B details the results of the 30 contracts we reviewed.

In addition to the 30 contracts we audited, we obtained historical data from DCAA about audit reports (excluding FAA) issued between FYs 2001 through 2005. During that time, DCAA identified \$48 million in questioned costs, of which the Department resolved about \$36 million. While resolving three-quarters of the questioned costs, the Department missed opportunities to identify and recover almost \$12 million in questioned contract costs. These conditions occurred because contracting officers did not consistently follow departmental and Federal Acquisition Regulation (FAR) guidance for obtaining incurred-cost audits, nor did they consistently take adequate action to resolve audit findings for the audits DCAA conducted.

The Office of the Senior Procurement Executive took a significant step to improve the process for obtaining contract audits after we briefed the office on our preliminary audit findings. In conjunction with our office, the Office of the Senior Procurement Executive met with DCAA to discuss best practices for obtaining audit support services. According to DCAA, agencies with large procurement activities, such as the Department of Defense, Department of Energy (DOE), and National Aeronautics and Space Administration (NASA), do not rely solely on individual contracting offices to select contracts for audit. Instead, these agencies work with DCAA to identify audit opportunities using a structured approach that takes into consideration the agency's entire contracting portfolio, contractor risk assessment, and the status of individual contracts. We realize that a change in approach of this magnitude is likely to take some time to effectively implement at DOT, but actions taken by the Senior Procurement Executive are good first steps.

The Office of the Senior Procurement Executive provided DCAA with a list of all DOT (excluding FAA) cost-reimbursable contracts having a value of more than \$1 million. DCAA was asked to identify contracts for audit and estimate the number of hours needed to perform incurred-cost audits. The Operating Administrations were provided with DCAA's recommendations in August 2006 to facilitate the development of their FY 2007 audit plans. However, Operating Administrations have made little progress in obtaining these audits. As of March 31, 2007, Operating Administrations had implemented less than 3 percent of the number of hours that DCAA recommended for DOT's high-risk contracts (356 audit hours implemented versus 13,934 hours recommended).

The Senior Procurement Executive's initiative to use a structured approach for obtaining contract audit services has the potential of significant cost savings for the Department. If fully implemented, this new process should reduce the Department's risk of fraud, waste, and abuse on cost-reimbursable contracts. However, DOT Operating Administrations need to obtain incurred-cost audits to fulfill this new structured approach and contracting officers need to resolve audit findings in a timely manner.

We provided a draft of this report to OST for comment on June 20, 2007, and on August 7 we received OST's response. OST generally concurred with our recommendations, stating that during the last 5 years, several alternatives were considered to obtain more incurred-cost audits. OST said that, unfortunately, these alternatives had not moved forward, due largely to resource constraints. A complete list of recommendations can be found starting on page 8 of this report. OST's response can be found in its entirety in the appendix.

FINDING

DOT's Operating Administrations Are Recovering Contractor Overpayments, but More Audits Are Needed

While the rate of recovery of contractor overpayments resulting from incurred-cost audits has been positive, contracting officers at seven of the eight Operating Administrations audited were not consistently obtaining such audits. As a result, the Department may have lost opportunities to recover additional questioned contract costs. This occurred because contracting officers did not follow the FAR and departmental guidance for obtaining audits.

We judgmentally selected for review 30 contracts valued at about \$1.2 billion. Contracting officers did not ask for incurred-cost audits on 18 of these contracts, valued at about \$600 million. The FAR requires contractors' indirect cost rates to be established annually, using contract audits, unless limited exceptions apply. The Department's Transportation Acquisition Manual (TAM) states, "Under most circumstances, DOT recognizes that . . . incurred-cost audits . . . are the preferred mechanism to assist the contracting officer in ensuring the validity of direct and indirect costs billed under cost-reimbursement contracts."

The TAM also requires contracting officers to justify and document in the contract files the reasons for not obtaining independent audits. Maintaining documentation is extremely important because it allows others who might assume responsibility for the contract to know what prior events and decisions have transpired. We found no such documentation for 17 of the 18 contracts. For the remaining one contract, the contracting officer provided adequate justification.

New Approach for Obtaining Audits Emphasizes Risk Assessment

In response to our preliminary conclusions that Operating Administrations would benefit from obtaining more audits, the Assistant Secretary for Administration issued a memorandum on November 22, 2005, emphasizing the importance of these audits under existing procedures and guidance. Further, in March 2006, the Office of the Senior Procurement Executive began working with DCAA and the Operating Administrations on a new approach to identify a best practice for obtaining audit support services.

According to DCAA, agencies with large procurement activities work with DCAA in a more structured approach to identify contracts for audit. Such an approach considers the agency's entire contracting portfolio, risk assessment on the contractors, and the status of individual contracts. After the analysis, procurement officials decide what audits to obtain.

For FY 2007, the Office of the Senior Procurement Executive began implementing such a structured approach for audit support services. DOT provided DCAA with a list of all cost-reimbursable contracts (excluding those of FAA) awarded between FYs 2003 and 2006 that had obligated funds greater than \$1 million each, with a total obligated value of about \$700 million. The Office of the Senior Procurement Executive requested that DCAA analyze the list and estimate the number of hours needed to perform incurred-cost audits.

DCAA estimated that about 23,000 hours, at an estimated cost of \$2.4 million, would be needed. According to DCAA, about 14,000 of these hours were needed to conduct audits of contracts it deemed high risk, based on experience with the contractors. These audits had an estimated cost of \$1.4 million. The Office of the Senior Procurement Executive provided the list to the Operating Administrations to use as a tool in estimating the number of hours of audit support required in FY 2007.

Operating Administrations Planned Only Two-Thirds of High-Risk Audits Recommended by DCAA, and Did Not Implement Their Own Plan to Obtain Audits

Despite DCAA's estimate, the Operating Administrations planned to obtain only about 8,700 hours, 63 percent of what DCAA identified as high risk. The Office of the Senior Procurement Executive did not require Operating Administrations to provide documentation justifying their deviations from DCAA's recommendations. However, as of March 31, 2007, Operating Administrations had requested only 356 contract audit hours, less than 3 percent of the 13,934 hours recommended for high-risk contracts (see table 1). While few audits have been requested, five of the eight Operating Administrations indicated their intention to obtain, in FY 2007, the planned number of audit hours. Operating

Administrations must ensure that needed incurred-cost audits are obtained and the Head of the Contracting Activity for each Operating Administration must be aware of these responsibilities.

Table 1. FY 2007 Contract Audits Recommended Versus Planned, as of March 2007

Operating Administration(OA)*	Total Audit Hours Recommended by DCAA**	Audit Hours Recommended for High-Risk Contracts by DCAA	Audit Hours Planned by OA	Audit Hours Requested by OA
FHWA	1,860	1,000	1,034	196
FRA	1,280	1,280	0	0
FTA	1,300	0	900	39
MARAD	1,520	1,360	3,556	0
NHTSA	0	0	40	0
OST	3,580	2,080	0	0
PHMSA	280	0	94	21
RITA/VOLPE	13,374	8,214	3,130	100
Total	23,194	13,934	8,754	356

* See Exhibit A for definitions of acronyms.

** Although DCAA indicated a potential for combining work, the number of hours shown assumes that each audit is accomplished independently and is not combined with other ongoing work at DCAA.

Contracting Officers Are Effectively Recovering Questioned Costs, but Opportunities for Improvement Exist

Contracting officers are taking effective actions to recover overpayments made to contractors and are achieving significant savings, but opportunities for improvement exist. DCAA identified \$48 million in questioned costs on all DOT contracts (excluding FAA) for FYs 2001 through 2005 (see table 2). DOT contracting officers addressed \$36.3 million of those questioned costs. Of that amount, they recovered about \$29.5 million—a sustention rate² of 81 percent. The DOT sustention rate is considerably higher when compared with the Federal Governments rate of 63 percent.³ However, contracting officers have not taken consistent actions in a timely manner to resolve the remaining \$11.7 million. By applying the sustention rates of 63 percent and 81 percent to the \$11.7 million, DOT has the potential to recover from \$7.4 million to \$9.5 million more in contractor overcharges.

² The sustention rate is calculated by dividing the questioned costs sustained by the questioned costs. Questioned costs sustained is that portion of costs questioned by the auditor upheld as a result of actions taken by either the contractor or the contracting officer during negotiations.

³ Based on DCAA data for FYs 2001 through 2005.

Table 2. Questioned Costs on All DOT Contracts by Operating Administration, FY 2001 through FY 2005

Operating Administration*	Questioned Costs (\$ in millions)
FHWA	\$41.8
FRA	\$ 1.4
FTA	\$.1
MARAD	\$ 4.1
NHTSA	\$ 0
OST	\$.2
PHMSA	\$ 0
RITA/VOLPE	\$.4
Total	\$48.0

* See Exhibit A for definitions of acronyms.

Of the 30 contracts we sampled during this audit, incurred-cost audits were performed on only 12. Contracting officers took actions to resolve questioned costs of about \$600,000 that DCAA identified for 3 of the 12 audited contracts. However, contracting officers took no action to recover about \$1 million of questioned costs on 6 contracts. By applying the sustention rates of 63 percent and 81 percent to the \$1 million, DOT has the potential to recover from \$630,000 to \$810,000 more in contractor overcharges. No action was required for the remaining three contracts.

Contracting officers stated that they wait until contract closeout to resolve DCAA audit reports, contrary to Federal regulations. However, the longer a contracting officer delays action to recover savings, the more difficult it may become to resolve discrepancies and other problems. Further, accurate records and knowledgeable personnel involved with the contract may become difficult to find. For example, in a contract for railroad services for a Government-owned, Federal Railroad Administration contractor-operated facility, valued at about \$42 million, DCAA questioned \$485,000. Although the audit was completed in 1999, the contracting officer would not act to recover the costs until the contract had been closed out. As of November 2006—7 years later—the contract still had not been closed because the contracting officer was waiting for a supplementary report from DCAA. The contracting officer asked DCAA to address an issue unrelated to the questioned costs of \$485,000 identified in the 1999 report. Although this is an example of a worst case scenario, DOT and its Operating Administrations need to be more vigilant in recovering savings from audits.

Office of Management and Budget Circular A-50 requires agencies to assign a high priority to the resolution of audit recommendations and to the implementation

of corrective actions. Its guidance states, “Resolution shall be made within a maximum of six months after issuance of a final report or, in the case of audits performed by non-Federal auditors, six months after receipt of the report by the Federal Government. Corrective action should proceed as rapidly as possible.”

We recognize that external circumstances beyond the control of the Operating Administrations, such as a contractor’s appeal of a contracting officer’s decision, may require resolution of audit findings to take more than 6 months. However, the Department should emphasize to Operating Administration contracting officers the importance of resolving audit findings in a timely manner.

Given the potential benefits of incurred-cost audits—such as savings of \$29.5 million for FYs 2001 through 2005—DOT must consider giving priority to those expenditures that yield such a good return on investment. The lack of audits also increases the vulnerability of DOT’s contracting dollars to fraud, waste, and abuse.

RECOMMENDATIONS

We recommend that the Assistant Secretary for Administration direct the Senior Procurement Executive to:

1. Require Operating Administrations to:
 - a. Review the FY 2007 contract audit plan submitted to the Office of the Senior Procurement Executive and document justifications for any revision;
 - b. Submit the revised FY 2007 contract audit plan to the Office of the Senior Procurement Executive for approval;
 - c. Resolve the \$12.7 million (\$11.7 million and \$1 million) in questioned costs that Operating Administrations have not addressed and report any resulting costs recovered to our office, the Senior Procurement Executive, and Administrators of each Operating Administration; and
 - d. Update the list of DCAA-reported unresolved questioned costs that are more than 6 months old as of October 2006; resolve those costs; and report any costs recovered to our office, the Senior Procurement Executive, and Administrators of each Operating Administration.
2. Ensure that Operating Administrations obtain incurred-cost audits and that audit report recommendations are resolved within 6 months of issuance of the final report.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

A draft of this report was provided to the Office of the Secretary of Transportation (OST) for comment on June 20, 2007, and on August 7 we received OST's response, which can be found in its entirety in the appendix. OST generally concurred with our recommendations and stated that during the last 5 years, several alternatives were considered to further the actions taken to obtain more incurred-cost audits. According to OST, unfortunately, aside from some limited application of the enhanced planning option, these alternatives have not moved forward, due largely to resource constraints. OST also said that dedicated contracting resources, both in the Operating Administrations and in the Office of the Senior Procurement Executive, must be increased in order for the Department to have sufficient capability to better ensure that contract audits are effectively planned, implemented, and acted upon.

OST further stated that without a detailed examination of each contract, the questioned costs, and the reason that the questioned costs have not been acted upon, it is impossible to determine the accuracy of potential recoveries. However, OST agreed that our estimated savings from \$8.0 million to \$10.3 million related to resolution of outstanding incurred-cost audits for FY 2001 through FY 2005 is reasonable for tracking purposes.

The corrective actions that OST plans to take adequately address the intent of our recommendations. Management responses to our recommendations are summarized below:

Recommendation 1.a.: OST concurred, stating that the Office of the Senior Procurement Executive will issue a memorandum to the Operating Administration Chiefs of the Contracting Offices within 30 days after the issuance of our final report. The memorandum will request Operating Administrations to review the FY 2007 contract audit plan and document justifications for revisions.

Recommendation 1.b.: OST concurred in part, stating that since it is well into the 4th quarter of the fiscal year, it would be most constructive for the Operating Administrations to identify planned contract audits that were not implemented in FY 2007 and include them in their FY 2008 audit plan. OST also stated that the memorandum described in response to recommendation 1.a. will include direction for Operating Administrations to provide a copy of the FY 2008 plan to the Office of the Senior Procurement Executive for review before the start of the fiscal year.

Recommendation 1.c.: OST concurred, stating that the memorandum described in response to recommendation 1.a. will encourage Operating Administrations to expeditiously complete action on any pending audit findings with questioned costs

and report the costs to the Head of the Contracting Activity (HCA) and the final disposition to the Office of the Senior Procurement Executive.

Recommendation 1.d.: OST concurred, stating that the memorandum described in response to recommendation 1.a. will direct the Operating Administrations to update the list of DCAA-reported unresolved questioned costs that are more than 6 months old as of October 2006, resolve those costs, and report results to the HCA and the Office of the Senior Procurement Executive.

Recommendation 2.: OST concurred in part, stating that the Office of the Senior Procurement Executive does not believe it is in a position to “ensure” our recommended actions. Instead, the Office of the Senior Procurement Executive will use the aforementioned memorandum to reiterate the Department’s policy to the Operating Administrations regarding the use of incurred-cost audits and the forum provided by the Procurement Management Council to ensure complete understanding of the policy. OST further stated that although it is not always possible to resolve audit report recommendations within 6 months of the issuance of the final report, in FY 2008, the Operating Administrations will begin submitting quarterly status reports against their audit plans. The status reports will address audit hours used, resolved and unresolved questioned costs, and whether justifications have been placed in the contract file where audits were not requested.

ACTION REQUIRED

OST’s planned actions satisfy the intent of our recommendations, subject to follow-up provisions in DOT Order 8000.1C. We appreciate the courtesies and cooperation of Department of Transportation representatives during this audit. If you have any questions, please call me at (202) 366-1496.

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cc: Deputy Secretary
Assistant Secretary for Programs and Budget/Chief Financial Officer
Martin Gertel, M-1

EXHIBIT A. SCOPE AND METHODOLOGY

We performed this audit at eight procurement offices of the following Operating Administrations:

- Federal Highway Administration (FHWA)
- Federal Railroad Administration (FRA)
- Federal Transit Administration (FTA)
- Maritime Administration (MARAD)
- National Highway Traffic Safety Administration (NHTSA)
- Office of the Secretary of Transportation (OST)
- Pipeline and Hazardous Materials Safety Administration (PHMSA)
- Research and Innovative Technology Administration (RITA) (Volpe National Transportation Systems Center)

We used the DOT Contract Information System to identify a universe and sample of cost-reimbursable contracts for audit. We initially selected a sample of 9 contracts, valued at about \$925 million, consisting of high-dollar-value contracts issued by the procurement offices of the Operating Administrations audited. We judgmentally selected the contracts reviewed from a universe of 570 cost-reimbursable and time-and-materials contracts with a value of about \$2.4 billion. Subsequently, at the request of the Office of the Senior Procurement Executive, we expanded the scope of contracts reviewed from 9 to 30. We judgmentally selected the additional 21 contracts with a value of about \$320 million from a universe of 395 cost-reimbursable and time-and-materials contracts with a value of about \$2.2 billion. We validated that the information in the DOT Contract Information System was reliable. We audited at least one contract from each of the eight procurement offices.

We reviewed documents maintained by procurement offices, such as price negotiation memorandums, DCAA audit reports, contractor invoices, and contract modifications. We chose for review contracts on which we believed sufficient time should have elapsed for incurred-cost audit activity to have occurred. We performed a detailed review of each contract, to include the contract files and

sources, such as DCAA information, to determine the extent of contract audit activity involving each contract.

To determine the costs identified by DCAA as questioned, we obtained data from DCAA's management information system on all DCAA DOT-related audit reports with questioned costs issued between October 2000 and September 2005. To develop an understanding and assess the reliability of the information included in the database, we held discussions with and obtained documentation from DCAA officials.

To determine the actions taken by DOT in response to DCAA audit findings, we selected the 12 contracts for which an incurred-cost audit had been performed. We obtained the DCAA audit reports for the 12 contracts and interviewed contracting officers to determine the actions taken to address the DCAA audit findings and looked for key documentation, such as price negotiation memorandums. We also used the data obtained from the DCAA management information system to identify the amount of questioned costs not addressed by contracting officers.

Additionally, we reviewed pertinent Federal and departmental acquisition regulations and guidance. We conducted this audit from February 2003 through March 2007 in accordance with Generally Accepted Government Auditing Standards prescribed by the Comptroller General of the United States and included such tests as we considered necessary to detect fraud, abuse, or waste.

EXHIBIT B. DETAILED RESULTS OF 30 CONTRACTS REVIEWED

Operating Administration	Contract Number	Audit Obtained?
FHWA	DTFH6102Z00001	Yes
	DTFH6103C00135	No*
	DTFH6197C00010	No
	DTFH6102C00007	No
	DTFH6196Z00046	No
FRA	DTFR5300C00012	Yes
	DTFR5301D00030	No
	DTFR5394A00060	No
	DTFR5393C00001	Yes
FTA	DTFT6098D41005	No
	DTFT6099D41008	Yes
MARAD **	DTMA9195C00024	Yes
	DTMA8C00002	Yes
	DTMA9190A10015	Yes
NHTSA	DTNH2201C07000	No
	DTNH2201C17000	No
	DTNH2201D01103	No
	DTNH2295D08168	No
OST	DTTS5999C00410	Yes
	DTOS5996D00415	Yes
	DTOS5996D00412	No
	DTOS5996D00428	No
	DTOS5996D00425	No
PHMSA	DTRS5696C0004	No
	DTRS5600C0001	No
RITA/VOLPE	DTRS5797C00107	Yes
	DTRS5700D30004	No
	DTRS5701D30003	Yes
	DTRS5700C10045	No
	DTRS5792C00077	Yes
Total		Yes = 12 No = 18

* Contracting officer adequately justified not obtaining an audit.

** MARAD consistently obtained audits (3 contracts/3 audits).

EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Mark H. Zabarsky	Deputy Assistant Inspector General for Financial Management Audits
Kenneth Prather	Program Director
Dana Short	Project Manager
Michael P. Fruitman	Communications Adviser
Lawrence Heller	Senior Auditor
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Allison Horkan	Auditor

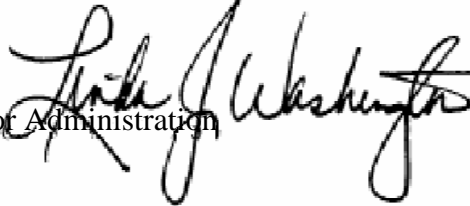
APPENDIX. MANAGEMENT COMMENTS



MEMORANDUM

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

Subject: **ACTION:** Response to Office of Inspector General (OIG)
Draft Report, "More Incurred-Cost Audits of DOT
Procurement Contracts Should Be Obtained" Date: August 7, 2007

From: Linda J. Washington
Assistant Secretary for Administration  Reply to
Attn. of:

To: David A. Dobbs
Principal Assistant Inspector General
for Auditing and Evaluation

We agree that audits, including incurred-cost audits for cost type contracts, are a critically important tool for ensuring that the Department's contracts are executed efficiently, effectively and at the lowest possible cost. The Office of the Senior Procurement Executive (OSPE) has consistently worked to provide the necessary guidance and direction for the Department's operating administrations (OA) to apply the appropriate use of audits for cost type contracts and to effect prompt action to determine whether questioned costs should be disallowed and recovered.

During the last 5 years, several alternatives were considered to further the actions taken in this area. For example, OSPE sought the capability to centrally manage audit funding to better manage the allocation and application of audit activity. Alternatively, if audit funding continues to be managed independently in each OA, OSPE requested a dedicated resource to oversee the use of audits and ensure they are properly resolved. As noted in discussions with OIG during the course of this review, this dedicated resource could leverage the Department's limited audit dollars, by enabling pooling where two or more OAs have cost contracts with the same contractor. Most recently OSPE developed a methodology whereby DCAA and the OAs work together to identify cost type contracts most suitable for audits and to better estimate the necessary audit hours. Discussions with the OA Chiefs of the Contracting Offices (COCOs) revealed that not all cost contracts identified by DCAA were of sufficient complexity to warrant auditor assistance. Therefore, rather than using the DCAA-provided list, in many cases, the COCOs opted to identify for themselves the contracts to be included in their fiscal year (FY) 08 audit plan.

Unfortunately, aside from some limited application of the enhanced planning option, these alternatives have not moved forward, due largely to resource constraints. Whichever alternative or methodology is employed to better manage the use and disposition of incurred-cost audits in the Department, greater resources will be necessary. Recent resource trends have not been encouraging. Staffing of the GS-1102 (procurement) career series in DOT has decreased over the past 5 years by ten percent. In OSPE, staffing has decreased by nearly half over the same period, while responsibilities have increased. Dedicated contracting resources, both in the OAs and in OSPE must be increased in order for the Department to have sufficient capability to better ensure that contract audits are effectively planned, implemented and acted upon.

Recommendations and Responses

Recommendation 1a: Require OAs to review the FY 2007 contract audit plan submitted to the Office of the Senior Procurement Executive and document justifications for any revision.

Response: Concur. Within 30 days after the issuance of the OIG final report OSPE will issue a memorandum to the OA COCOs calling upon them to review the FY 2007 contract audit plan and document justifications for revisions.

Recommendation 1b: Require OAs to submit the revised FY 2007 contract audit plan to the Office of the Senior Procurement Executive for approval.

Response: Concur in part. Since it is now well into the 4th quarter of the fiscal year, it would be most constructive for the OAs to identify planned contract audits not implemented during FY 07 and include them in their FY 08 audit plan. Further, justification and approval of audit plans are a responsibility of each COCO and their Administrator. However, to encourage timely and effective completion of each OAs contract audit plan, the memorandum described above will include direction to provide OSPE with a copy of the FY 08 plan for review prior to the start of the fiscal year.

Recommendation 1c: Require Operating Administrations to resolve the \$12.7 million (\$11.7 million and \$1 million) in questioned costs that OAs have not addressed and report any resulting costs recovered to our office, the Senior Procurement Executive, and Administrators of each OA.

Response: Concur. The aforementioned memorandum will encourage OAs to expeditiously complete action on any pending audit findings with questioned costs. These costs should be reported to the Head of the Contracting Activity (HCA) and OSPE will also request a copy of the information describing final disposition.

Recommendation 1d: Require Operating Administrations to update the list of DCAA-reported unresolved questioned costs that are more than 6 months old as of October 2006; resolve those costs; and report any costs recovered to our office, the Senior Procurement Executive, and Administrators of each Operating Administration.

Appendix. Management Comments

Response: Concur. The aforementioned memorandum will include direction to the OAs to complete the recommended actions and report results to the HCA and to OSPE.

Recommendation 2: Ensure that Operating Administrations obtain incurred-cost audits and that audit report recommendations are resolved within 6 months of issuance of the final report.

Response: Concur in part. OSPE will use the aforementioned memorandum to reiterate the Department's policy to the OAs regarding the use of incurred-cost audits. In addition, it will use the forum provided by the Procurement Management Council to ensure that there is complete understanding of the policy. However, lacking direct management control of each OA's contract administration offices, or a centralized capability to direct and fund audits, OSPE is not in a position to ensure the recommended actions. Further, it is not always possible to resolve audit report recommendations within 6 months of the issuance of the final report because some contracts are more complex and resolution may require additional actions by DCAA or the contractor. As an alternative, in FY 08 the OAs will begin submitting quarterly status reports against their audit plans. The status reports will address audit hours used, resolved and unresolved questioned costs, and whether justifications have been placed in the contract file where audits were not requested.

Other Action Requested: The draft report requested management comment on its \$8.0 to \$10.3 million savings estimate related to additional incurred-cost audits for FY 2001 through FY 2005. Management understands, through discussions with the OIG that this range represents an extrapolation of historic sustainment rates of questioned costs applied to the pending \$12.7 million of questioned costs outstanding from previous audits. While we understand the basis of the estimate, it is not possible without a detailed examination of each contract, the costs questioned, and the reason that they have not been acted upon, to determine whether a straight line extrapolation offers an accurate estimate of potential recoveries. Nonetheless, lacking more precise estimates, it is not an unreasonable estimate to be used for tracking purposes.