

**GAO**

United States General Accounting Office

Report to the Chairman, Subcommittee  
on Oversight and Investigations,  
Committee on Energy and Commerce,  
House of Representatives

October 1991

**ENERGY  
MANAGEMENT**

**Contract Audit  
Problems Create the  
Potential for Fraud,  
Waste, and Abuse**



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Resources, Community, and  
Economic Development Division

B-245871

October 11, 1991

The Honorable John D. Dingell  
Chairman, Subcommittee on  
Oversight and Investigations  
Committee on Energy and Commerce  
House of Representatives

Dear Mr. Chairman:

In January 1990 GAO began implementing a special audit effort to help ensure that areas vulnerable to fraud, waste, abuse, and mismanagement are identified and that appropriate corrective actions are taken. This effort focuses on 16 areas, one of which is the Department of Energy's (DOE) contracting practices. As part of this effort, you requested that we determine if contract audits for monitoring and overseeing DOE's contracting process were being performed and that we identify the impact or potential impact to the government when contract audits were not performed. Specifically, this report discusses (1) audit coverage of DOE's management and operating (M&O) contractors and DOE contracts,<sup>1</sup> (2) the problems that may occur when contract audit activity is not performed, and (3) factors that have impeded contract audit coverage.

## Results in Brief

Even though it contracted out about \$17.6 billion in fiscal year 1990 for goods and services, DOE lacks assurance that its oversight and control of contract expenditures, through contract auditing, will deter and detect potential fraud, waste, and abuse. That is, DOE's Office of Inspector General (OIG) has reported to the Congress, beginning in April 1990, that DOE managers lack adequate OIG assurance that the M&O contractors are operating economically, efficiently, and in the federal government's best interest. The assurance is lacking because the OIG's cyclical audit coverage of DOE's largest contractors—the integrated M&O contractors<sup>2</sup>—has been incomplete because of staffing and resource limitations.

<sup>1</sup>In addition to M&O contracts for the management and operation of DOE's research and production facilities, this report focuses on DOE cost-reimbursement contracts and subcontracts, which are referred to as non-M&O contracts throughout the report.

<sup>2</sup>Integrated M&O contractors (1) have their costs under a cost-type contract prefinanced by DOE and (2) are required to maintain a separate system of accounts, records, documents, and other evidence to support all allowable costs incurred, revenues, or other applicable credit.

In addition, because non-M&O contracts can go unaudited for years, DOE does not know whether (1) it paid a fair and reasonable price for such contracts and (2) the contract costs claimed by non-M&O contractors were accurate and allowable. Our work showed numerous instances, involving millions of dollars, in which the government was potentially overbilled or the amounts paid and/or claimed were questionable. These instances arose during our review of a judgmental sample of 19 non-M&O contracts and subcontracts that were completed but not closed out. For these contracts and subcontracts, many of the contract audits were not performed or were not timely.

Several factors have hindered appropriate non-M&O contract audit coverage. First, DOE lacks guidance—with established target dates and a procedure for tracking progress against such dates—to aid its offices in monitoring and following up on (1) non-M&O contract audit activity it has actually requested or (2) contract audit performance carried out by the agency having audit responsibility for each contract. This agency, referred to as the cognizant audit agency, is usually the Defense Contract Audit Agency (DCAA) for DOE contracts. Second, DCAA (1) puts a lower priority on some audits, such as incurred cost audits, which review the accuracy and allowability of direct and indirect costs charged to a contract, and (2) has had a backlog of incurred cost audits, in part because of an increasing work load and limited staff resources.

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## Background

An efficient and effective contract management and administration program requires contract audits to help ensure that the (1) government pays a fair and reasonable price for the services and products it receives and (2) costs contractors claim are accurate and allowable. DOE contract expenditures for goods and services include contracts awarded for M&O contracts and other prime contracts. Cost-reimbursement contracts are another major type of DOE prime contract. In addition, the M&O contractors award subcontracts for goods and services. DOE's eight operations offices are responsible for overall contract management.

In fiscal year 1990, DOE contract obligations totaled about \$17.6 billion. Most of these funds—\$13.4 billion—were obligated to DOE's integrated M&O contractors. About \$400 million was also obligated to nonintegrated M&O contractors. Of the \$13.8 billion obligated to M&O contractors, over \$5 billion was for subcontracts awarded by M&O contractors. Obligations for other DOE prime contracts totaled about \$3.8 billion. During fiscal year 1990, DOE had 44 integrated M&O contracts and 8 nonintegrated M&O contracts. This report does not focus on nonintegrated M&O contractors.

Contract audit oversight and control of the integrated M&O contractors are covered through DOE's Voucher Accounting for Net Expenditures Accrued (VANEA) process. Under this process the M&O contractor is required to prepare and certify annually, through the VANEA, that the net expenditures accrued have been incurred and are allowable under the contract. The VANEA forms the basis for the OIG's annual audit of the contractor's system of accounts and the contractor's allowable costs claimed. To carry out its VANEA responsibilities, the OIG developed a cyclical audit plan to provide audit coverage of contractor operations and documentary support to be used when signing the VANEA. Under this plan every significant function of each M&O contractor's operation should be audited at least once every 5 years. At the end of each fiscal year, representatives for the M&O contractor, the DOE operations office, and the DOE OIG are required to certify and approve that the net costs incurred were allowable under the M&O contract.

Contract audit services for non-M&O contracts are provided by the cognizant audit agency. DCAA is the cognizant audit agency for most DOE contracts. DCAA is reimbursed for audit services provided to DOE. Both the federal government and DOE have specific regulations addressing contract administration, including contract audits.

Contract audits can occur throughout a contract's life cycle. For example, once a contract is awarded, a number of post-award audits are required. These audits include incurred cost audits. When the contract is completed, it must be closed out. This closeout process includes determining that contract work has been completed, receiving pertinent bills and other paperwork from the contractor, and having a final audit done, if needed. DOE must request the cognizant audit agency to audit the final costs incurred before a completed contract can be closed out. Regulations require closeout of cost-reimbursement contracts within 36 months from the time when the agency receives evidence that work has been completed and receives pertinent paperwork from the contractor.

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## Audit Coverage of M&O Contractors Is Incomplete

Because of staffing and resource limitations, DOE's OIG has not provided the cyclical audit coverage it had established as necessary to determine if the costs incurred by the agency's integrated M&O contractors are accurate, allowable, and reasonable. In addition, the internal auditors working for the integrated M&O contractors have often not performed required allowable cost audits. For these reasons, in fiscal year 1990,

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the OIG did not sign the required annual financial statements of contractor operations (the VANEAs), qualified its opinion, or disclaimed an opinion on nearly all of the VANEAs. As a result, the DOE's OIG has reported to the Congress, since April 1990, that DOE managers lack adequate OIG assurance that DOE's major contractors are operating economically, efficiently, and in the federal government's best interest. These semiannual reports to the Congress have continuously acknowledged slow progress in completing the required audits under the OIG's 5-year cyclical audit plan, principally because of staffing and resource limitations.

Our recent testimony and report on DOE's oversight of M&O contractors' subcontracting practices further illustrate (1) the problems DOE has with managing M&O contractors and (2) the need to focus increased audit attention on such contractors.<sup>3</sup> In this testimony we stated that DOE's M&O subcontracts are vulnerable to fraud, waste, and abuse. Poor procurement practices of the M&O contractors, coupled with inadequate oversight by DOE, have led to contractors' incurring excessive subcontract costs.

As of the third year of the 5-year cycle, only 384 of an estimated 2,500 needed audits had been completed. At the current staffing level and rate of accomplishment, the cyclical audit coverage, according to the OIG, may take as much as 20 years, rather than the planned 5 years. The OIG has requested about a 38-percent increase in fiscal year 1992 staffing for auditing the annual operating statements of the integrated M&O contractors. Even if this increase is approved, the OIG has estimated that the audit cycle would only be reduced from 20 years to 16 years.

Furthermore, annual audit coverage by the M&O contractors' internal auditors has been incomplete. Many of the VANEAs certification statements were not signed because the integrated M&O contractors' internal auditors did not perform allowable cost audits in fiscal year 1990,<sup>4</sup> even though such audits are specifically required in most M&O contracts. However, in its April 1991 report to the Congress, the OIG reported that efforts to improve contractors' internal audit performance are under way.

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<sup>3</sup>DOE Management: DOE Needs to Improve Oversight of Subcontracting Practices of Management and Operating Contractors (GAO/T-RCED-91-79, Aug. 1, 1991) and Energy Management: DOE Actions to Improve Oversight of Contractors' Subcontracting Practices (GAO/RCED-92-28, Oct. 7, 1991).

<sup>4</sup>These audits determine if the costs incurred by the contractor were allowable under the contract.

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Appendix I discusses the audit coverage of M&O contractors provided by both the DOE OIG and the M&O contractors' internal auditors.

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## Non-M&O Contract Audits Not Done or Not Timely

Other contract audit problems are affecting non-M&O contracts that have been completed but not closed out. Our review of 19 such contracts,<sup>5</sup> with total obligations of \$228 million, indicated numerous instances, involving millions of dollars, in which the government was potentially overbilled or the amounts paid and/or claimed were questionable. These instances resulted, in part, because post-award contract audits were either not always performed or not always performed in a timely manner. This has been a problem area for a long time. For example, the OIG reported in 1984 that contracts were not being closed out in a timely manner and that many lower-valued contracts were being closed out without adequate field or desk audits being performed.

The contracts we reviewed illustrate several problems that can result from an absence of contract audit activity. For instance, DCAA did not conduct any incurred cost audits for one contract from 1983 to 1989. When the incurred cost audits were conducted, they revealed overbillings between 1982 and 1989 of about \$1.4 million, and the audits questioned unallowed costs of an additional \$2.1 million for this contract. The unallowable costs claimed included such items as alcoholic beverages, unauthorized spouse travel, and registration for golf tournaments.

According to the DOE official who first identified the overpayments, the contractor knowingly overbilled the government, not only for this contract but also for several others the contractor had with DOE, and maintained the overpayments in a special account. As of July 1991, DOE had recovered almost \$1.3 million from the contractor for all of the contract overbillings.

To show the potential impact that this overbilling could have on the federal government, we calculated that the contractor could have earned about \$1 million in interest on the total overpayments made. Although DOE operations office officials told us that the contractor may not have to pay DOE any of the interest potentially earned on the overpayments,

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<sup>5</sup>We judgmentally selected, on the basis of the contract's dollar value and age since completion, 13 non-M&O cost-reimbursement contracts awarded by DOE's Albuquerque, Oak Ridge, and San Francisco operations offices; and 6 cost-reimbursement subcontracts awarded by 3 M&O contractors operating at the same 3 DOE operations office locations. As of Sept. 30, 1990, DOE had about 1,300 non-M&O cost-reimbursement contracts that had been completed but not closed out. DOE did not have summary information on the number of cost-reimbursement M&O subcontracts that had been completed but not closed out.

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DOE's Oak Ridge operations office requested in a July 1991 letter that the contractor pay DOE about \$498,000 in interest that DOE had calculated that the contractor could have earned on the overpayments made between 1982 and 1985. As of September 1991, this issue was still under discussion between DOE and the contractor.

In addition, we found the following:

- Seventeen of the 19 contracts lacked a final audit of incurred cost, generally referred to as the closeout audit; 9 of the 17 contracts were completed 6 to 14 years ago.
- Eight contracts had not had the contractors' indirect rates and/or incurred costs audited for all of the period covering the contract.<sup>6</sup> Two of the eight contracts, totaling approximately \$73 million, had not had any incurred cost audits, according to our review. These eight contracts were completed 2 to 14 years ago.

As the contracts we reviewed show, without audits, a greater potential exists that (1) overpayments may not be discovered in a timely manner and (2) discrepancies will be more difficult to resolve. For example, four of the contracts involved questions concerning the differences in the amount the government paid and the incurred cost the contractors claimed. However, overpayment determinations cannot generally be made until final incurred cost audits are performed.

Another contract, involving \$9 million, illustrates that the longer the period of time that the contract remains unaudited, the more difficult it becomes to resolve any potential discrepancies and/or other problems. This contract ran from 1975 to 1980 without any incurred cost audits until 1989, 14 years after the contract's inception. After the audit, a senior accountant for the contractor stated in a letter to DCAA that the amounts in DCAA's audit report did not agree with any of the contractor's billings, reports, or schedules. The DOE official responsible for closing out this contract said this issue is still being mediated. In addition, the contract files showed a \$706,000 discrepancy between what the contractor claimed as its final costs and what DOE's records show as the agency's total payments. The DOE official currently responsible for closing out this contract cannot explain the discrepancy because he does not have first-hand knowledge of the contract. He is relying on the final

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<sup>6</sup>Indirect rate audits examine the contractor's overhead expenses. Incurred cost audits examine both the direct and indirect costs charged to the contract. Indirect costs can be determined only after the indirect rates have been established.

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closeout audit to resolve the discrepancy. Thus, the final incurred costs remain undetermined 11 years after the contract was completed.

We also noted in our review of the 19 contracts that until all required audits are conducted and a contract is closed out, DOE is denied use of the otherwise available funds remaining obligated to completed contracts. At the end of fiscal year 1990, we found that DOE had over \$71 million still obligated to over 1,300 cost-reimbursement contracts that had been completed but not closed. The work on some of these contracts was finished years ago, sometimes, as the contracts we reviewed show, more than a decade ago. Appendix II summarizes the results of our review of the 19 contracts and discusses several of them in detail.

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## Factors Impeding Non-M&O Contract Audit Coverage

The extent to which non-M&O contract audits have been requested and performed was greatly influenced by two factors: (1) DOE's lack of guidance establishing specific target dates for accomplishing all needed contract audit activities and a procedure for tracking progress against such dates and (2) DCAA's audit priorities and audit work load. Appendix III discusses these factors in detail.

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## Monitoring, Tracking, and Following Up

DOE does not have agencywide guidance with established target dates to aid its offices in monitoring and following up on all contract audit activities. Two of the three operations offices we visited had begun implementing local information systems for monitoring requests for audits of incurred costs, but these systems were incomplete. As a result, DOE headquarters and the operations offices were generally unaware of the audit status of all contracts.

DOE headquarters procurement officials believe that existing audit guidance, as established in various DOE regulations and memorandums, provides clear and detailed coverage on the requirements for audit services. These officials also told us that because certain contracting officers appear to lack knowledge of the requirements, or otherwise do not comply with the requirements, this should not reflect on the requirements themselves.

During our contract review work at the three DOE operations offices, we noted a variety of problems involving contract audits. For example, contracting officials did not always know what audits are required for a

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contract or contractor, if or when an audit was requested, if the contractor submitted documentation necessary for the audits, and if any follow-up action was warranted and taken.

In addition to the contracts cited earlier, two other contracts we reviewed illustrate the problems that occur when monitoring, tracking, and following up are not performed:

- One contract had no requests for the documents necessary for closeout until almost 7 years after the contract's completion. The documents still had not been received as of July 1991. Until these documents are provided, the contract cannot be closed because DCAA cannot furnish DOE with a contract closing statement.
- In another contract, DOE made no attempt to obtain the contractor documents necessary for closeout, according to our review. The contractor finally submitted the documents 7 years after contract completion, but DOE misplaced them and did not request them again until 1 year later. As a result, DCAA could not complete a closeout statement until 8 years after the contract was completed.

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### DCAA Gives Lower Priority to the Performance of Some Contract Audits

The performance of contract audits has also been affected by the lower priority given to some post-award audits, such as incurred cost audits, by DCAA, the cognizant audit agency for DOE's non-M&O contracts. According to DOE officials, DOE contracts often receive lower priority for audit coverage because they have smaller dollar amounts than Department of Defense contracts. DCAA officials stated, however, that DCAA's audit priorities for such small-dollar contracts are the same for both DOE and the Department of Defense.

DOE headquarters procurement officials also told us that contract auditing is resource-intensive and that available DCAA staffing to carry out such work has been declining. Furthermore, whether DOE contracting officers request an audit on a timely basis or not, such requests will probably not result in a timely audit. This has been the case for many years, according to these officials; contracting officers have known this and have too often not documented in the files requests for audits that were going to go unanswered.

According to DCAA officials, while the timing for conducting incurred cost audits is normally self-initiated, the audits must be accomplished to facilitate the government's final contract payment to contractors. The incurred cost area is essentially the only area over which DCAA has any

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control over timing/initiation of audit performance. Therefore, budget constraints affect this area more severely than other areas.

Although a detailed examination of DCAA's audit priorities and audit work load was beyond the scope of this review, recent work we have completed and an August 1991 OMB initiative address these issues. Specifically, in December 1990 testimony before your Subcommittee on the auditing of contracts awarded by the Environmental Protection Agency,<sup>7</sup> we reported that DCAA has had backlogs of incurred cost audits for years, in part as a result of increasing work loads during the military buildup of the 1980s, according to DCAA officials. This backlog grew from about \$33 billion in contracts in fiscal year 1981 to nearly \$170 billion in fiscal year 1989. However, DCAA officials told us in August 1991 that as a result of increased staffing and a decline in preaward audit requests, the growth in this backlog has been stopped and some progress made in catching up on prior-year audits. The backlog declined to \$161.3 billion at the end of fiscal year 1990. DCAA anticipates that this backlog will be further reduced in the future, to about \$138.5 billion by the end of fiscal year 1992.

Our December 1990 testimony also recommended that the Administrator of the Environmental Protection Agency work with other federal agencies, including the Office of Management and Budget (OMB), to develop ways to expedite audit coverage of contractors. Our discussions with DCAA officials confirmed that the issues raised in our December 1990 testimony still exist.

In June 1991 your Subcommittee issued a report on the activities of the Environmental Protection Agency's Office of Inspector General. This report included our December 1990 testimony and made recommendations to OMB on federal contract audit activities. In August 1991 OMB responded to two of the recommendations by creating an interagency task force on contract auditing. The task force's overall goal is to develop recommendations for improving federal contract audit coverage. An immediate objective is to clarify responsibility for audit cognizance and, before the end of October 1991, make recommendations to OMB regarding formal designations. A longer-term objective is to study mechanisms to improve the auditing of government contracts, including an analysis of the feasibility and desirability of creating a separate

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<sup>7</sup>EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-RCED-91-5, Dec. 11, 1990).

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agency to audit such contracts. This study should be completed by the end of March 1992.

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## Conclusions

The OIG began reporting in April 1990 that its audit coverage of the billions of dollars in costs incurred by DOE's integrated M&O contractors has been and will continue to be incomplete because it lacks the staff resources needed to perform the required audits. As a result, DOE managers do not know whether these contractors are operating economically, efficiently, and in the government's best interest. Furthermore, because of either nonperformance or untimely performance of post-award audit activity involving non-M&O contracts, DOE lacks adequate assurance that (1) it paid a fair and reasonable price for the contract services it received and (2) the costs claimed by the contractors were accurate and allowable.

The problems we noted in our review of non-M&O contracts illustrate the need for agencywide guidance establishing specific target dates for accomplishing needed contract audit activities. This guidance, combined with appropriate mechanisms to monitor, track, and follow up on contract audit activities, would aid DOE officials in identifying (1) the contract audits each contract is subject to and the contractor documents required to conduct the audits; (2) when audits and contractor documents should be requested; (3) whether the audits and documents were requested, performed, and/or received; and (4) the reason(s) audits and documents were not requested, performed, and/or received.

Our review of contracts also shows that, in many instances, when contract audits are performed, problems are found. If such audits are not done or are not done in a timely manner, contract administration is hampered, monetary losses to the government may occur, and the potential exists for fraud, waste, and abuse.

Even though we believe that agencywide guidance would help DOE and its M&O contractors better address audit requirements and prevent them from going unnoticed for long periods of time, such guidance is only part of the solution. The need for the cognizant audit agency—DCAA—to conduct the requested audits in a timely manner has also impeded the contract closeout process. As we stated in our December 1990 testimony on similar contract closeout problems involving the Environmental Protection Agency, the full resolution of contract audit problems requires the involvement of other federal agencies, as users and suppliers of audit services, and OMB, which establishes various audit policies. Therefore,

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we view OMB's August 1991 creation of an interagency task force on contract auditing as a positive step in this direction.

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## Recommendations

We recommend that the DOE Inspector General describe, in his next semi-annual report to the Congress, the actions being taken by his office and those being taken by the Secretary of Energy to provide the OIG with the audit resources needed to reasonably assure DOE that the integrated M&O contractors are operating economically, efficiently, and in the federal government's best interest.

To aid operations offices and M&O contractors in monitoring and following up on all contract audit activities, we also recommend that the Secretary of Energy develop and implement guidance on establishing target dates for accomplishing all needed contract audit activities and a procedure for tracking progress against these target dates.

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We performed our work between July 1990 and September 1991 according to generally accepted government auditing standards. We visited DOE headquarters in Washington, D.C., and DOE's operations offices in Oak Ridge, Tennessee; Albuquerque, New Mexico; and San Francisco, California. Additional information on our objectives, scope, and methodology is contained in appendix IV.

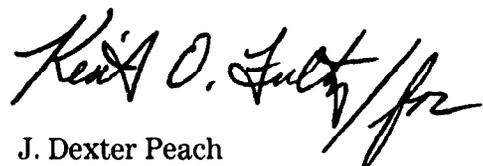
As agreed with your office, we did not obtain written agency comments on a draft of this report. We did, however, discuss the facts with responsible DOE and DCAA officials and incorporated their comments where appropriate. In general, they agreed with the facts presented.

As arranged with your office, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Energy; the Inspector General, Department of Energy; the Director, Office of Management and Budget; and other interested parties. We will also make copies available upon request.

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This work was performed under the direction of Victor S. Rezendes, Director, Energy Issues, who may be reached on (202) 275-1441 if you or your staff have any questions. Major contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Kent O. Fultz/fr". The signature is written in a cursive style with a large, sweeping flourish at the end.

J. Dexter Peach  
Assistant Comptroller General



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**Abbreviations**

CAS	Cost Accounting Standards
DCAA	Defense Contract Audit Agency
DEAR	Department of Energy Acquisition Regulation
DOE	Department of Energy
FAR	Federal Acquisition Regulation
FTE	full-time equivalent
M&O	management and operating
OIG	Office of Inspector General
OMB	Office of Management and Budget
VANEA	Voucher Accounting for Net Expenditures Accrued

# Audit Coverage of Management and Operating Contractors Is Incomplete

The Department of Energy's (DOE) Office of Inspector General (OIG) has not provided the cyclical audit coverage necessary to determine if the costs incurred by the agency's integrated management and operating (M&O) contractors,<sup>1</sup> who have received billions of dollars (about \$13.4 billion in fiscal year 1990 alone), are accurate, allowable, and reasonable. This appendix provides further information on

- the progress the OIG has made in completing work under its cyclical audit plan,
- the extent of the OIG's approval of integrated M&O contractors' allowable costs, and
- the extent to which the integrated M&O contractors' internal auditors have examined allowable costs.

## Background

An efficient and effective contract management and administration program requires contract audits to help ensure that the (1) government pays a fair and reasonable price for the services and products it receives and (2) costs contractors claim are accurate and allowable. One major type of DOE contract is the M&O contract for the management and operation of DOE's research and production facilities. For example, Martin Marietta Energy Systems, American Telephone and Telegraph, and the University of California are M&O contractors at DOE's Oak Ridge, Albuquerque, and San Francisco facilities, respectively.

DOE contract expenditures for goods and services include contracts awarded for both M&O contracts and other prime contracts. In addition, the M&O contractors also award subcontracts for goods and services. In fiscal year 1990, DOE contract obligations totaled about \$17.6 billion. Most of these funds—\$13.4 billion—were obligated to DOE's integrated M&O contractors. About \$400 million was also obligated to nonintegrated M&O contractors. Of the \$13.8 billion obligated to M&O contractors, over \$5 billion was for subcontracts awarded by M&O contractors. DOE's eight operations offices are responsible for overall contract management. These offices are located in Albuquerque, New Mexico; Argonne, Illinois; Idaho Falls, Idaho; Las Vegas, Nevada; Oak Ridge, Tennessee; Richland, Washington; Oakland, California; and Aiken, South Carolina.

<sup>1</sup>Integrated M&O contractors (1) have their costs under a cost-type contract prefinanced by DOE and (2) are required to maintain a separate and distinct system of accounts, records, documents, and other evidence showing and supporting all allowable costs incurred, revenues, or other applicable credit. During fiscal year 1990, DOE had 44 integrated M&O contracts and 8 nonintegrated M&O contracts.

Contract audit oversight and control of the integrated M&O contractors are covered through DOE's Voucher Accounting for Net Expenditures Accrued (VANEA) process. Under this process, the M&O contractor is required to prepare and certify annually, through the VANEA, that the net expenditures accrued have been incurred and are allowable under the contract. The VANEA forms the basis for the OIG's annual audit of the contractor's system of accounts and the contractor's allowable costs claimed. To carry out its VANEA responsibilities, the OIG developed a cyclical audit plan to provide audit coverage of contractor operations and documentary support to be used when signing the VANEA. Under this plan every significant function of each M&O contractor's operation should be audited at least once every 5 years. At the end of each fiscal year, representatives for the M&O contractor, the DOE operations office, and DOE OIG are required to certify and approve that the net costs incurred were allowable under the M&O contract.

The OIG has different opinions it can express on the VANEA. For example, an unqualified opinion indicates that based on sufficient audit review and testing, controls are in place to assure that only allowable costs are charged to the contract. A qualified opinion indicates that the audit has identified a non-material weakness. And a disclaimed opinion indicates the existence of a material control weakness, such as the lack of an internal audit clause or inadequate internal audit staff.

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## Slow Progress in Completing OIG's Cyclical Audit Plan

The OIG's 1988 long-range plan to provide needed audit coverage of DOE's integrated contractors outlines 12 primary functions that should be audited cyclically, at least once every 5 years. The 12 functions are (1) procurement; (2) personnel; (3) construction and facilities; (4) information management; (5) safeguards and security; (6) environment, safety, and health; (7) financial; (8) government property; (9) quality assurance; (10) traffic and transportation; (11) planning and budget; and (12) other support services. There are about 60 secondary functions within the 12 primary functions. Some examples of these secondary functions are cash management, financial accounting and reporting, budget formulation, and document classification.

The plan does not specify which functions are to be audited in which year of the cycle. The scheduling of the individual audits within the 5-year cycle is based on such considerations as requests, vulnerability, dollar volume, staffing, risk, and prior experience. Because of limited staff resources, the OIG has not progressed in completing the required audits as originally planned. As of fiscal year 1990, the OIG was in the

third year of the 5-year cycle. DOE has obligated over \$37 billion to its integrated M&O contractors during the 3 years the long-range plan has been in effect.

As of the third year of the 5-year cycle, only 384 of an estimated 2,500 needed audits had been completed. In considering audit coverage, the OIG does not rely strictly on the work it performs but also accepts work performed by others, including the M&O contractor's internal auditors. For example, the allowable cost audit activities of the internal auditors is one component that the OIG would consider in its audit oversight of M&O contractors.

The OIG had a total of 197 full-time equivalent (FTE) staff agencywide in fiscal year 1990, of whom 53 were dedicated to the VANEA certification process. At this staffing level, the VANEA auditing process, according to the OIG, will require a 20-year audit cycle to provide complete audit coverage, rather than the planned 5-year cycle. Therefore, according to the OIG, the VANEA statements can only be, at best, "qualified" because audit resources are insufficient to allow for the normal audit steps required by financial and compliance audit standards. As a result, DOE's OIG has reported to the Congress since April 1990 that DOE managers lack adequate OIG assurance that DOE's major contractors are operating economically, efficiently, and in the federal government's best interest.

For fiscal year 1992, the OIG requested 73 FTEs for auditing the annual operating statements of the integrated M&O contractors, an increase of 20 FTEs over the current level. The additional 20 FTEs, according to the OIG, would reduce the audit cycle from 20 years to 16 years. To attain the audit coverage required in the planned 5-year cycle, the OIG reported that 240 FTEs would be needed, an increase of 187 FTEs over the current level. As of early September 1991, the OIG's fiscal year 1992 staffing level had not been made final.

Our recent testimony and report on DOE's oversight of M&O contractors' subcontracting practices further illustrate (1) the problems DOE has with managing M&O contractors and (2) the need to focus increased audit attention on such contractors.<sup>2</sup> In the testimony we stated that DOE's M&O

<sup>2</sup>DOE Management: DOE Needs to Improve Oversight of Subcontracting Practices of Management and Operating Contractors (GAO/T-RCED-91-79, Aug. 1, 1991) and Energy Management: DOE Actions to Improve Oversight of Contractors' Subcontracting Practices (GAO/RCED-92-28, Oct. 7, 1991).

subcontracts are vulnerable to fraud, waste, and abuse. Poor procurement practices of the M&O contractors, coupled with inadequate oversight by DOE, have led to contractors' incurring excessive subcontract costs. Among other things, DOE's reviews have shown that M&O contractors often do not ensure that subcontract prices are fair and reasonable, and these contractors are also restricting competition by inappropriately using sole-source purchases. In the testimony, we also stated that while the DOE reports do not estimate the extent of overpricing that is likely to be associated with the procurement weaknesses identified, we estimated that millions of dollars may be wasted each year.

## **OIG Has Not Generally Approved Contractors' Allowable Costs**

Since the 5-year plan was implemented, the OIG generally has not signed the VANEAs, which would signify its approval of the contractor's representation of allowable costs. For the 1990 statements completed at the time of our review, for example, the OIG rendered 4 unqualified opinions, 10 qualified opinions, and 22 disclaimers, according to the OIG's Director of Financial Audits. According to the Director, when the OIG disclaims an opinion on an M&O's VANEAs statement, the contracting officer could, among other things, (1) order the M&O to take corrective action; (2) disallow the costs claimed, using the reason(s) for the disclaimed opinion; or (3) recommend a reduction in the award fee. Even when the OIG signs the VANEAs statement, it is only acknowledging that the net expenditures accrued represent allowable contract costs, subject to adjustments if a later audit discloses unallowable costs.

Examples from both the OIG's Eastern and Western regions further demonstrate the extent to which the OIG's VANEAs statement activity has been carried out. The Eastern Region, for example, had not signed the VANEAs statements in 29 of the 44 opportunities available between 1988 and late 1990 for the contractors under its cognizance. The total obligations for the 29 instances were about \$9.6 billion. Over one-third of the 29 statements were not signed because the financial and compliance audits had not been completed or the OIG had not completed its review of the internal auditors' workpapers. For five of the contractors, the VANEAs statements have not been signed for any of the 3 years that the OIG's long-range plan has been in effect. DOE had obligated over \$6 billion to

these five contractors during the 3-year period, most of it—over \$4 billion—was obligated to the integrated M&O contractor for the Savannah River facility.<sup>3</sup>

In some instances, the M&O contractors have not had any audits under the 5-year plan. For example, the Western Region's OIG summary data on functional area coverage showed that three M&O contractors have not had audits for any of the 12 major subject areas. Collectively, these three M&O contractors—Hanford Environmental Health Foundation, MK Ferguson Construction, and Protection Technology—were obligated over \$150 million for fiscal years 1988, 1989, and 1990.

## Internal Auditors Did Not Complete Audits of Allowable Costs

The OIG has not signed many of the VANEA certification statements because the internal auditors working for integrated M&O contractors have not performed the allowable cost audits in the past, even though such audits are specifically required in most M&O contracts. However, in its April 1991 report to the Congress, the OIG reported that efforts to improve contractors' internal audit performance are under way.

For fiscal years 1988, 1989, and 1990, the OIG has not signed the VANEA statement in seven instances in the OIG's Eastern Region because the internal auditors have not performed the allowable cost audits. In eight other cases, the VANEA statement has not been signed pending completion of the internal audits by the internal audit staffs. The OIG's Western Region office disclaimed an opinion on 13 of the fiscal year 1990 VANEA statements it issued because the M&O contractors' internal audit staffs had not performed the allowable cost audits. In the Eastern Region, the OIG did not sign the VANEA statements for three contractors in fiscal year 1990. For one contractor in the Eastern Region, the OIG has not signed the VANEA statement for any of the 3 years of the long-range plan because no allowable cost audits have been performed. The contractor—Universities Research Association, Inc.—was obligated over \$600 million during this 3-year period.

For fiscal year 1990, a similar situation existed with an M&O contractor—Martin Marietta Energy Systems—for the Oak Ridge facility. The OIG, in November 1990, reported that the internal auditors had not performed the allowable cost audits for fiscal year 1990. However, for

<sup>3</sup>E.I. du Pont de Nemours (DuPont) managed and operated the Savannah River facility for DOE from the 1950s until Apr. 1, 1989, when the Westinghouse Savannah River Company became the new operating contractor for the facility.

this same M&O contractor, the OIG reported over \$600,000 in unallowable costs in an audit of the contractor's overtime and staff management of its security patrol department from November 9, 1989, through August 13, 1990. The objective of the audit was to determine if overtime and staff were adequately managed. The vast majority of the unallowable costs identified—\$447,600—involved inaccurate reporting of hourly, weekly, and monthly time cards, and payable hours not calculated in accordance with the applicable labor agreement. These conditions occurred because of inadequate internal controls.

Even when the internal auditors have performed the allowable cost audits, they have generally identified insignificant unallowable cost findings, according to OIG officials. We could not determine, however, the overall amount of unallowable cost findings reported by the integrated M&O contractors' internal auditors because the OIG does not maintain summary data on such information, according to the OIG's Assistant Inspector General for Audits.

According to DOE operations office and OIG officials, so few unallowable cost findings have been identified because the M&O contract provisions specify very few costs that are considered unallowable. For example, a 1990 OIG report on the San Francisco operations office said the unallowable cost clause in the University of California's M&O contract does not consider the reasonableness of costs and prudent business judgment. The report also stated that the "clause essentially states that no costs are unallowable unless there was willful misconduct on the part of Laboratory Directors."

In recent testimony concerning DOE laboratories operated by the University of California,<sup>4</sup> we reported that the contracts with the University do not include the standard DOE Acquisition Regulation clause requiring that the contractor conduct internal audits and examinations satisfactory to DOE of the records, operations, expenses, and transactions with respect to the costs claimed to be allowable under the contract. In a March 1991 memorandum on internal controls at the Lawrence Livermore Laboratory operated by the University, DOE's OIG stated that the lack of the internal audit clause and its requirements was a material

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<sup>4</sup>DOE Management: Management Problems at the Three DOE Laboratories Operated by the University of California (GAO/T-RCED-91-86, July 31, 1991).

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**Appendix I  
Audit Coverage of Management and  
Operating Contractors Is Incomplete**

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internal control deficiency. DOE is currently negotiating with the University of California to change the allowable cost provision of the M&O contract, according to DOE's Director, Office of Policy, Office of Procurement, Assistance, and Program Management.

In its April 1991 semiannual report to the Congress, the OIG stated that the increase in time required to complete its cyclical audit coverage of integrated M&O contractors has been due in part to a lack of reliance on internal audit work at some of DOE's larger integrated contractors. The OIG also reported that OIG reviews of internal audit performance at some locations showed that certain contractually required allowable cost audits were not performed in an acceptable manner. On the positive side, however, the OIG also reported in April 1991 that efforts to improve contractor internal audit performance were under way.

# Contract Audits for Non-M&O Contracts Were Not Performed or Were Not Timely

Our review of 19 contracts<sup>1</sup> showed numerous instances that demonstrate the importance of non-M&O contract audit coverage.<sup>2</sup> Because no audits were done, or the audits were untimely, millions of dollars were either potentially overbilled to the government or subject to questions concerning the proper amount paid and/or claimed. This contract review work, summarized in table II.1 at the end of this appendix, shows that

- complete audit coverage was not performed or was not timely and
- the lack of contract audits or timely audits may potentially increase government costs and hamper contract administration because (1) a greater potential exists for possible overpayments to contractors to go undetected, (2) discrepancies and other problems become more difficult to resolve, and (3) use of obligated funds is restricted.

## Background

An efficient and effective contract management and administration program requires contract audits to help ensure that the (1) government pays a fair and reasonable price for the services and products it receives and (2) costs contractors claim are accurate and allowable. DOE contract expenditures for goods and services include contracts awarded for M&O contracts and other prime contracts. Cost-reimbursement contracts are another major type of DOE prime contract. In addition, the M&O contractors award subcontracts for goods and services. Our contract review work focuses on these cost-reimbursement contracts and subcontracts (for purposes of this report, these contracts and subcontracts are referred to as non-M&O contracts).

In fiscal year 1990, DOE contract obligations totaled about \$17.6 billion. Most of these funds—\$13.4 billion—were obligated to DOE's integrated M&O contractors. About \$400 million was also obligated to nonintegrated M&O contractors. Of the \$13.8 billion obligated to M&O contractors, over \$5 billion was for subcontracts awarded by M&O contractors. Obligations for other DOE prime contracts totaled about \$3.8 billion.

<sup>1</sup>We judgmentally selected, on the basis of the contract's dollar value and age since completion, 13 non-M&O cost-reimbursement contracts awarded by DOE's Albuquerque, Oak Ridge, and San Francisco operations offices; and 6 cost-reimbursement subcontracts awarded by 3 M&O contractors operating at the same 3 DOE operations office locations. These 19 contracts had total obligations of about \$228 million. As of Sept. 30, 1990, DOE had about 1,300 non-M&O cost-reimbursement contracts that had been completed but not closed out. DOE did not have summary information on the number of cost-reimbursement M&O subcontracts that had been completed but not closed out.

<sup>2</sup>Both the federal government and DOE have specific regulations addressing contract administration, including contract audits. These regulations are referred to as the Federal Acquisition Regulation (FAR) and the Department of Energy Acquisition Regulation (DEAR), respectively.

Contract audit services for non-M&O contracts are provided by the cognizant audit agency. The Defense Contract Audit Agency (DCAA) is the cognizant audit agency for most DOE contracts. DCAA's cognizance, according to a September 1991 memorandum of understanding between DOE and DCAA, is determined by one of the following: (1) the Office of Management and Budget (OMB) has assigned the responsibility to the Department of Defense; (2) the Department of Defense has the predominant financial interest on the basis of contract activity; or (3) the agency with the predominant financial interest and DCAA have agreed that DCAA will be the cognizant agency. DCAA is reimbursed for audit services provided to DOE. Both the federal government and DOE have specific regulations addressing contract administration, including contract audits.

Contract audits can occur throughout a contract's life cycle. For example, once a contract is awarded, a number of post-award audits are required. These audits include incurred cost audits. When the contract is completed, it must be closed out. This closeout process includes determining that contract work has been completed, receiving pertinent bills and other paperwork from the contractor, and having a final audit done, if needed. DOE must request the cognizant audit agency to audit the final costs incurred before a completed contract can be closed out. The regulations require closeout of cost-reimbursement contracts within 36 months from the time when the agency receives evidence that work has been completed and receives pertinent paperwork from the contractor.

## Post-Award Audit Coverage Is Incomplete

Complete audit coverage of non-M&O contracts in our sample was often not provided in a timely manner or was not provided at all. For example:

- Seventeen of the 19 contracts lacked a final audit of incurred cost, generally referred to as the closeout audit; 9 of the 17 contracts were completed 6 to 14 years ago.
- Eight contracts had not had the contractors' indirect rates and/or incurred costs audited for all of the periods covering the contract.<sup>3</sup> Two of the eight contracts, totaling approximately \$73 million, had not had any incurred cost audits at all, at the time of our review in May 1991.<sup>4</sup> These eight contracts were completed 2 to 14 years ago.

<sup>3</sup>Indirect rate audits examine the contractor's overhead expenses. Incurred cost audits examine both the direct and indirect costs charged to the contract. Indirect costs can be determined only after the indirect rates have been established.

<sup>4</sup>As of July 1991, however, DCAA officials informed us that DCAA is in the process of auditing the costs for one of these contracts.

The following examples (listed in table II.1) from our contract review work illustrate the type of problems that result from incomplete and untimely contract audits.

Contract 1 involved a \$38 million contract that began in 1981 and was completed in 1989. DCAA audited the 1981 costs in 1982, but did not conduct any additional audits until 1990, 8 years later. When the audits of incurred costs for 1982 to 1989 were conducted by DCAA, they revealed contractor overbillings of about \$1.3 million for all its contracts with DOE, of which about \$1.4 million was for the contract we reviewed.<sup>5</sup> The audits also questioned unallowable costs of about \$3.5 million, with about \$2.1 million related to the contract we reviewed. The unallowable costs claimed included such items as alcoholic beverages, unauthorized spouse travel, and registration for golf tournaments.

According to the official with the DOE operations office who first identified the overpayments, the contractor knowingly overbilled the government, not only for this contract but for several others the contractor had with DOE, and maintained the overpayments in a special account. As of July 1991, DOE had recovered almost \$1.3 million from the contractor for all of the contract overbillings. DOE is also negotiating with the contractor on the final amount the contractor owes DOE for the questioned unallowable costs.

To illustrate the potential impact that this overbilling could have on the federal government, we calculated that the contractor could have earned about \$1 million in interest on the total overpayments made. Although DOE operations office officials told us that the contractor may not have to pay DOE any interest potentially earned on the overpayments, DOE's Oak Ridge operations office requested in a July 16, 1991, letter that the contractor pay DOE about \$498,000 in interest that DOE had calculated that the contractor could have earned on the overpayments made between 1982 and 1985. According to the letter, DOE believed that the contractor "knew of, or reasonably should have known, of these overbillings but did not notify DOE when they occurred during the 1982-1985 time period, or for several years thereafter." The letter also stated that considering the amount of time that had passed and the contractor's "failure to notify, we believe DOE is entitled to an

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<sup>5</sup>The amount of the overbilling for our selected contract was more than the overbilling for all of the contractor's DOE contracts together because the contractor significantly underbilled some other contracts after the overbilling problem was identified.

equitable adjustment for lost interest on these overbillings." As of September 1991, this issue was still under discussion between DOE and the contractor.

The audits were not initially performed because the DOE procurement officials responsible for requesting DCAA to perform the incurred cost audits did not make any audit requests nor did they obtain from the contractor and provide to DCAA documents necessary to conduct the audits. Instead, according to the currently responsible DOE official, DOE apparently relied on DCAA to conduct the audits and obtain the documents on its own initiative. However, if DOE fails to request the audits or obtain the documents, DCAA is not responsible for conducting the audits, according to the memorandum of understanding between DOE and DCAA.

On the basis of information obtained during a 1989 management review of the contractor's facility, DOE intensified its oversight of this contract. According to the DOE official responsible for requesting contract audits, one of the contractor's employees informed her that the contractor had been overbilling DOE. The employee further informed the official that the company was keeping track of the amount overbilled by entering it into a separate account. Subsequently, the DOE official obtained the documents necessary to conduct the incurred cost audits and requested DCAA to perform the audits, which showed the total overbilled amount to be about \$1.4 million for the contract we reviewed. If DOE had requested the incurred cost audits annually, as the DEAR requires, and if DCAA had conducted them, the overbillings and unallowable costs could have been detected earlier and the overpayment could have been recovered much sooner.

Contract 3 involved a 1987 contract for environmental cleanup work for about \$1.1 million that had increased to \$2.6 million at its completion in 1988. As of July 1991, DCAA, the cognizant audit agency for this contractor, had not conducted any incurred cost audits for the contract. However, the contract potentially has a high risk of containing unallowable or inaccurate costs, according to the DOE official responsible for requesting post-award audits, because the contract has already incurred almost \$1.6 million in cost overruns. The official did not anticipate DCAA's conducting the incurred cost audits for another 2 years, so she requested the DOE OIG to audit the contract's direct costs and leave the indirect costs to DCAA's audit. As a result of the DOE OIG audit, DOE noted a procedural finding in overtime practices. According to DOE correspondence, the contractor does not require its exempt salaried employees to record uncompensated overtime which may result in an unequitable

allocation of costs to the government. This failure may cause labor and overhead costs (based on actual hours worked) to be improperly allocated.

Contract 5 has not had a closeout audit, although the contract was completed over 14 years ago. For reporting purposes, DOE considers contracts as "overage" if the contract has not been closed out within 36 months from the time when the agency receives evidence that work has been completed and receives pertinent paperwork from the contractor. However, contractor files showed that DOE did not request a closeout audit until 1983—6 years after the contract was completed. DOE's records showed that no other documented requests for a closeout audit were made again to DCAA until 1988. DCAA eventually started the audit but cancelled the audit assignment in October 1990 because the contractor could not provide the cost records necessary to perform the audit.

Our review of the contract files revealed about a \$700,000 discrepancy between the amount DOE paid the contractor—\$5.9 million—and the amount of costs the contractor claimed in its summary settlement statement—\$5.2 million. DOE officials were unable to satisfactorily explain the reason for this difference. If DOE had made a more timely closeout audit request, the contractor's cost records might have been available for DCAA to conduct the audit and explain the discrepancy.

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## **Contract Audit Problems Potentially Increase Costs and Hamper Contract Administration**

When audits are not performed or not performed in a timely manner, the government has little assurance that it paid a fair and reasonable price for the costs of goods and services it received or that costs claimed by contractors are accurate and allowable. For example, without audits, a greater potential exists that overpayments will not be discovered and discrepancies will be more difficult to resolve.

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## **Greater Potential Exists for Contractor Overpayments**

When audits are not conducted for a period of years, the potential is greater for overpayments to the contractor to go unidentified, as our review of contracts showed. Overpayments may occur when the contractor (1) bills DOE for more than its actual costs or (2) claims costs that are unallowable. Overpayments deny DOE use of the funds until they are identified and recovered, as well as any interest accrued on the overpayments. Moreover, the lack of timely audits provides contractors with

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little incentive to ensure they are correctly billing for the goods and services they provide.

Many of the 19 contracts in our sample revealed potential overpayments to the contractor, according to DCAA audits. For example, as previously discussed, contract 1 involved overpayments to the contractor of about \$1.4 million. In addition, the contractor for contract 19 received potential overpayments of about \$4.3 million for all government contracts, according to an incurred cost audit. The potential overpayments resulted from expenses the contractor incurred and charged to its government contracts during a change in its ownership. The actual overpayment amount is being determined through negotiations between DOE and the contractor. Finally, another contractor, (contract 2), which had a contract worth about \$7.2 million, received a potential overpayment of about \$105,000, according to a closeout audit. The contract was completed in 1982, but the closeout audit was not conducted until 1990. The audit revealed that DOE had paid about \$105,000 more than the audit recommended as the contractor's allowable costs. As of July 1991, the contractor was analyzing its records to determine if the audit was accurate about the overpayment.

Still other contracts (contracts 4, 5, 10, and 17) raised questions concerning the differences in the amount the government paid and the incurred cost the contractors' claimed. However, overpayment determinations cannot be made until final incurred cost audits are performed.

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**Discrepancies and Other  
Problems Are More  
Difficult to Settle**

The longer the period of time that contracts remain unaudited, the more difficult it becomes to resolve any potential discrepancies and/or other problems. Accurate records become more difficult to find, as do knowledgeable personnel who were involved with the contract.

For example, contract 14 involved a \$2.5 million contract, completed in 1983, that has not been closed—even though the incurred cost audits were completed in 1989—because the contractor claimed DOE directed it not to pay state gross receipt taxes that New Mexico had assessed on the basis of the contract's value. The state assessed the contractor \$21,000 for the taxes, including penalties and interest. The contractor, however, believes that DOE should pay the money because DOE informed the contractor that it did not have to pay the taxes. DOE disagrees with the contractor's claim. This disagreement remains unsettled because adequate

records documenting the events and negotiations that actually transpired do not exist. Furthermore, personnel initially responsible for the contract 8 or more years ago are no longer with DOE.

In another instance, contract 10 involved a \$9 million contract from 1975 to 1980, without any incurred cost audits until 1989, 14 years after the contract's inception. In 1989, DCAA audited the incurred costs for the entire contract period. After the audit, a senior accountant for the contractor stated in a letter that the amounts in DCAA's audit report did not agree with any of the contractor's billings, reports, or schedules. The DOE official responsible for closing out this contract said this issue is still being mediated. In addition, the contract files showed a \$706,000 discrepancy between what the contractor claimed as its final costs and what DOE's records show as the agency's total payments. The DOE official currently responsible for closing out this contract cannot explain the discrepancy because he does not have first-hand knowledge of the contract. He is relying on the final closeout audit to resolve the discrepancy. Thus, the final incurred costs remain undetermined 11 years after the contract was completed.

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### **Use of Obligated Funds Is Restricted**

Until all required audits are conducted and a contract is closed out, DOE is denied use of the otherwise available funds remaining obligated to completed contracts. The FAR specifies time frames for closeout activities—36 months for cost-reimbursable contracts and 6 months for fixed-price contracts. At the end of fiscal year 1990, agencywide, DOE had over \$71 million still remaining obligated to over 1,300 cost-reimbursement contracts that had been completed but not closed. In many instances, the work on the contracts was finished years ago, sometimes more than a decade ago. About \$25.5 million was obligated to contracts that had been completed for over 3 years and that should have been closed out.

The contracts we reviewed showed similar conditions. For the 19 contracts, about \$1.8 million still remained obligated as of July 1991, even though most of the contracts were completed from 6 to 14 years ago. For example, contract 1 has almost \$1 million still obligated and contract 5, which was completed about 14 years ago, still has \$172,379 obligated.

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

**Table II.1: Contract Review Results for 19 DOE Non-M&O Contracts**

<b>Service/product provided</b>	<b>Final amount obligated</b>	<b>Amount still obligated</b>	<b>Start/complete dates</b>	<b>Preaward audit (and for contract modifications)</b>	<b>Indirect rate audit (audit date/ year audited)</b>	<b>Incurred cost audit (audit date/ year audited)</b>
<b>Contract 1<sup>a</sup> contract number DE-AC05-81OR20676</b> Feasibility studies, conceptual designs, and engineering services			5-14-81 5-13-89	2-18-81	1991 1986-89	1991 1986-89
	\$38,309,592	\$905,451				
<b>Contract 2<sup>a</sup> contract number DE-AC05-76OR04890</b> Engineering study of "Liquid Metal Fast Breeder Reactor Fuel Storage Facility"			3-11-75 9-30-82	None identified	1988 1982	1988 1982
	\$7,238,790	\$48,683				
<b>Contract 3<sup>a</sup> contract number DE-AC05-87OR21616</b> Environmental cleanup: preparation and transportation of solid radioactive waste for off-site disposal			2-1-87 8-31-88	1-7-87	None conducted	1990—direct costs (pending DCAA audit of indirect costs)
	\$2,649,700	\$1,216				
<b>Contract 4<sup>a</sup> contract number DE-AC05-79ORO5695</b> Perform gas centrifuge research and development work			2-22-78 9-30-80	12-19-77	Actual date not known 1978-80	1982 1978-80
	\$1,592,728	\$4,021				

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Estimating system review</b>	<b>Operational audits</b>	<b>Cost accounting standards (CAS) review</b>	<b>Closeout audit</b>	<b>Other audit</b>	<b>Discussion</b>
None identified	None identified	5-20-88—Review found CAS statement inadequate; compliance review not conducted	Pending negotiation of 1982-89 rates and costs	Accounting audit 1983	No indirect rate or incurred cost audits conducted from 1982-89. When conducted, audits revealed overbillings of about \$1.4 million on this case contract. No DOE follow-up on inadequate CAS statement for over 3 years. As a result, CAS compliance audit could not be conducted. Further detail about this contract are discussed on pp. 5-6, 25-26, 28, 29, 39-40, and 41 of this report.
None identified	None identified	3-20-90	11-16-90—Revealed potential overpayment of \$104,526; settlement pending	None identified	Closeout conducted 8 years after contract completion, partially because DOE did not obtain final voucher for 7 years. DOE lost the voucher and requested it again 1 year later. Audit of 1982 rates questioned costs for items such as 1st class travel. Further details about this contract are discussed on p. 28 of this report.
None identified	Timekeeping procedures 1988	3-20-90	Pending indirect rate and cost audits of 1987-88	Procurement audit—12-15-88	DOE funded over \$1 million in overruns—increased costs without a change in the scope of work. Procurement audit identified potential unnecessary increased cost to DOE because the contractor overpaid its subcontractor \$27,968. Further details about this contract are discussed on pp. 8, 26-27, and 42 of this report.
None identified	None identified	None identified	Pending closeout as of 1982	None identified	No evidence of follow-up after closeout request 9 years ago. Discrepancies between 2 of contractor's claimed cost statements. DOE also potentially paid contractor \$51,922 more than it claimed. Further details about this contract are discussed on p. 28 of this report.

(Continued)

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Service/product provided</b>	<b>Final amount obligated</b>	<b>Amount still obligated</b>	<b>Start/complete dates</b>	<b>Preaward audit (and for contract modifications)</b>	<b>Indirect rate audit (audit date/ year audited)</b>	<b>Incurred cost audit (audit date/ year audited)</b>
<b>Contract 5<sup>a</sup> contract number DE-AC05-76OR04131</b> Architect and engineering services			11-18-70 3-31-77	None identified	1982 1977	1976 1973
	\$6,096,586	\$172,379				
<b>Contract 6<sup>b</sup> contract number 85X-40406C</b> Information and software support for the Air Force Data Systems Design Office			6-17-85 9-30-89	8-16-85	1990 1986	1990 1986
	\$22,591,258	\$96,291				
<b>Contract 7<sup>b</sup> contract number 53Y21453C</b> Research and development for microwave devices			4-17-79 9-30-84	11-21-83— Questioned \$68,924	1991 1983	1991 1983
	\$8,986,099	\$0				
<b>Contract 8<sup>d</sup> contract number DE-AT03-81SF11572</b> Environmental cleanup: crystalline ceramic nuclear waste form development			9-30-81 2-28-83	10-1-81	1989 1983	1989 1983
	\$1,017,000	\$11,847				
<b>Contract 9<sup>d</sup> contract number DE-ACO3-76 ET53057</b> Studies of component plasma concepts and plasma and the "General Atomic Doublet" experiment			5-1-74 1-22-88	None identified	1990 1988	1990 1988
	\$10,992,815	\$60,612				
<b>Contract 10<sup>d</sup> contract number DE-AC03-76ET28443</b> Thermal Loop Experimental Facility			7-1-75 6-1-80	None identified	1985 1980	1989 1975-80
	\$9,078,707	\$33,787				

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Estimating system review</b>	<b>Operational audits</b>	<b>Cost accounting standards (CAS) review</b>	<b>Closeout audit</b>	<b>Other audit</b>	<b>Discussion</b>
None identified	None identified	None identified	DCAA cancelled the audit assignment	None identified	Potential overpayment identified of \$700,000. 1976 report on rates identified a \$50,063 overbilling. DCAA cancelled closeout audit assignment because of insufficient contractor records. DCAA also has no audit records from the contract period. Further details about this contract are discussed on pp. 27, 28, and 29 of this report.
8-26-88	None conducted	3-30-88—Noncompliance identified	Pending 1987-89 incurred cost audits	None identified	1987-89 incurred cost audits delayed because the M&O contractor did not obtain subcontractor documents. Documents finally submitted about 1991. CAS noncompliance cost impact not yet calculated.
None identified	None identified	None identified <sup>c</sup>	Pending 1984 incurred cost audits	None identified	1982 indirect rate audit questioned \$208,876 for items such as entertainment. Further details about this contract are discussed on p. 40 of this report.
None identified	None identified	None identified <sup>c</sup>	Pending final voucher	None identified	Cost incurred audits not completed until 1989, 6 years after contract completion. No evidence of any DOE request to contractor for final voucher. Further details about this contract are discussed on p. 40 of this report.
None identified	None identified	None identified <sup>c</sup>	Pending rate negotiations and final voucher	None identified	All necessary rate and incurred cost audits completed. Pending negotiation of 1987 and 1988 rates and contractor submission of final voucher. Further details about this contract are discussed on p. 40 of this report.
None identified	None identified	None identified	Pending final voucher	None identified	All necessary rate and incurred cost audits completed. Closeout not requested until 1982 and not followed up on until 1986. Potential overpayment of \$706,420 identified. Further details about this contract are discussed on pp. 6-7, 28, and 29 of this report.

(Continued)

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Service/product provided</b>	<b>Final amount obligated</b>	<b>Amount still obligated</b>	<b>Start/complete dates</b>	<b>Preaward audit (and for contract modifications)</b>	<b>Indirect rate audit (audit date/ year audited)</b>	<b>Incurred cost audit (audit date/ year audited)</b>
<b>Contract 11<sup>d</sup> contract number DE-AC03-79SF10499</b> Integration services and design and fabrication of equipment and support systems for the Solar Pilot Plant			12-15-78 9-13-83	None identified	1984 1983	None conducted
	\$52,292,952	\$100,605				
<b>Contract 12<sup>e</sup> contract number 5817009</b> Evaluation of fusion reactor subsystems and short wave-length fusion laser system			7-2-79 8-31-81	Waived	1984 1981	1984 1981
	\$327,888	\$1,511				
<b>Contract 13<sup>e</sup> contract number 5141700</b> Engineering services for magnetic fusion program and other mechanical engineering projects			3-1-85 8-31-88	None identified	In process	In process
	\$21,051,922	\$0				
<b>Contract 14<sup>f</sup> contract number DE-AC04-80AL12041</b> Technical assistance and support services for administration of utility companies			9-1-80 8-31-83	6-26-80	Date unknown 1983	1989 1983
	\$2,523,457	\$4,445				
<b>Contract 15<sup>f</sup> contract number DE-AC04-84AL26550</b> Contract audit support services			9-26-84 2-29-88	Waived 9-13-84	1988 1985	1988 1985
	\$2,071,245	\$28,050				
<b>Contract 16<sup>f</sup> contract number DE-AT04-79ET25102</b> Sodium sulfur battery development			3-1-79 6-29-85	None identified	1989 <sup>g</sup> 1984	1989 <sup>g</sup> 1984
	\$21,267,936	\$154,169				

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Estimating system review</b>	<b>Operational audits</b>	<b>Cost accounting standards (CAS) review</b>	<b>Closeout audit</b>	<b>Other audit</b>	<b>Discussion</b>
None identified	None identified	None identified	Pending final voucher	None identified	Audit of 1983 rates questioned about \$7.3 million in costs. Almost \$6.4 million of this amount was for independent research and development. Incurred costs will not be audited until closeout—over 12 years after contract inception. Closeout pending final voucher submission, which DOE has not requested.
None identified	None identified	None identified	Pending contractor submittal of closeout document and DOE request for closeout	None identified	Required contractor submittal of final voucher not requested until 7 years after contract completion. DOE has not requested closeout as of July 1991. Further details about this contract are discussed on pp. 8 and 42 of this report.
None identified	None identified	None identified <sup>c</sup>	Pending 1985-88 incurred cost audits	None identified	No request for incurred cost audits until 4 years after contract inception and no follow-up for 1-1/2 years. Audits of 1985-87 costs in process as of July 1991. Audit of 1988 costs still pending. Further details about this contract are discussed on p. 40 of this report.
None identified	None identified	None identified	8-9-89 pending negotiations with contractor regarding additional costs claimed	None identified	DOE did not follow up on closeout audit request for 5 years. Closeout finally conducted 6 years after contract completion. Disagreement pending regarding contractor's cost claim for state taxes. Further details about this contract are discussed on pp. 28-29 of this report.
None identified	None identified	None identified	Pending 1986-88 incurred cost audits	None identified	Pending submittal of contractor documents so audits of 1986-88 audits can be done. No evidence of DOE attempts to obtain the submissions.
None identified	5-23-85	None identified	Pending 1985 rate negotiations and final voucher	None identified	Findings from 1984 labor review of the contractor resulted in \$2.5-million net savings and \$3.1-million cost avoidance.

(Continued)

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Service/product provided</b>	<b>Final amount obligated</b>	<b>Amount still obligated</b>	<b>Start/complete dates</b>	<b>Preaward audit (and for contract modifications)</b>	<b>Indirect rate audit (audit date/ year audited)</b>	<b>Incurred cost audit (audit date/ year audited)</b>
<b>Contract 17<sup>i</sup> contract number DE-AC04-79ET20631</b> Kilowatt solar photovoltaic power system development			9-30-79 11-30-83	8-28-79	None identified	None identified
	\$3,146,429	\$54,061				
<b>Contract 18<sup>h</sup> contract number 52-9817</b> Conceptual design for the proposed Nevada nuclear storage repository			2-1-84 12-31-87	8-15-84	1991 1986	1989 1987 (Direct costs only; indirect costs pending DCAA audit)
	\$6,586,205	\$32,638				
<b>Contract 19<sup>h</sup> contract number 61-1523</b> Design of system for transporting defense waste			8-10-81 7-18-86	6-25-81	1991 1986	1991 1986
	\$10,167,516	\$60,000				

**Appendix II  
Contract Audits for Non-M&O Contracts  
Were Not Performed or Were Not Timely**

<b>Estimating system review</b>	<b>Operational audits</b>	<b>Cost accounting standards (CAS) review</b>	<b>Closeout audit</b>	<b>Other audit</b>	<b>Discussion</b>
None identified	None identified	None identified	DOE attempting to waive closeout because of insufficient records	None identified	No DOE or DCAA evidence of post-award audits conducted for this contract. DOE did not follow up on closeout request for 7 years. Contractor cannot be located. Potential overpayment of over \$200,000 identified. Further details about this contract are discussed on pp. 28 and 39 of this report.
None identified	None identified	1987 report identified noncompliance with cost impacts of over \$10.7 million for government contracts between 1980-86.	Pending 1987 indirect rate and cost audits	None identified	An audit of 1986 incurred costs questioned \$4.3 million in engineering expenses charged to all government contracts. The contractor voluntarily credited the government that amount. Further details about this contract are discussed on p. 40 of this report.
None identified	None identified	None identified	Pending negotiation of 1984-86 rates	None identified	An audit for 1986 incurred costs questioned about \$4.3 million in costs for all government contracts. The costs resulted from the contractor's change in ownership. Further details about this contract are discussed on p. 28 of this report.

<sup>a</sup>Contract administered by Oak Ridge Operations Office.

<sup>b</sup>Contract administered by Martin Marietta Energy Systems.

<sup>c</sup>In these four contracts, a CAS review was conducted after the contract was completed. To illustrate the cost impacts resulting from these reviews, however, we included a brief discussion of these four contracts in app. III.

<sup>d</sup>Contract administered by San Francisco Operations Office.

<sup>e</sup>Contract administered by University of California.

<sup>f</sup>Contract administered by Albuquerque Operations Office.

<sup>g</sup>While this contract was not completed until 1985, costs were only incurred through 1984. As a result, only audits of the rates and costs through 1984, and not 1985, pertain to this contract.

<sup>h</sup>Contract administered by American Telephone and Telegraph.

# Factors Impeding Non-M&O Contract Audit Coverage

The extent to which non-M&O contract audits have been requested and performed was greatly influenced by two factors: (1) DOE's lack of guidance establishing specific target dates for accomplishing all needed contract audit activities and a procedure for tracking progress against such dates and (2) DCAA's audit priorities and audit work load. Both factors are discussed in this appendix.

## DOE Lacks Emphasis on Post-Award Audit Coverage

One of the principal reasons that post-award audits of non-M&O contracts were not performed or were not performed in a timely manner is DOE's lack of emphasis in this area. For example, DOE lacks guidance on establishing target dates for accomplishing all needed contract audit activities and a procedure for tracking progress against such target dates. As a result, DOE cannot be assured that contract audits and contractor documents necessary to conduct the audits are requested and appropriate contract audit monitoring and follow-up activities take place.

DOE's OIG reported a similar lack of emphasis in a 1984 report on the closeout of completed contracts. The OIG reported that contracts were not being closed out because (1) DOE procurement officials delayed requesting audits and receiving required field audit coverage when requested and (2) the closeout documentation was not being requested promptly, target dates for receipt of the documentation were not established, and follow-up actions were not taken. In addition, the report pointed out that there were no management records to accurately identify whether the required audits had been requested or performed.

The FAR and DEAR contain specific criteria for the performance of certain post-award audits, such as incurred cost audits and Cost Accounting Standards (CAS) compliance reviews. According to DOE's Director of Business and Financial Policy, Office of Procurement, Assistance, and Program Management, DOE does not provide any additional guidance because the DEAR is straightforward and does not require any interpretation. As a result, the decision governing the applicability of overall contract audit requirements is generally left to the discretion of the contracting officer, who may or may not comply with or fully understand the FAR and DEAR criteria, as our review of contracts showed.

According to procurement officials at DOE headquarters, existing audit guidance, as established in various DOE regulations and memorandums, provides clear and detailed coverage on the desirability of, types of, and requirements for audit services. These officials added that because certain contracting officers appear to lack knowledge of the requirements,

or otherwise do not comply with the requirements, this should not reflect on the requirements themselves.

DOE headquarters and the operations offices we visited were generally unaware of the audit status of all DOE contracts. For example, we found that contracting officials do not always know what audits are required for a contract or contractor, if or when an audit was requested, if the contractor submitted documentation necessary for the audits, and if any follow-up action was warranted and taken. As of 1991, two of the three operations offices we visited—Oak Ridge and Albuquerque—were implementing local information systems for monitoring requests for audits of incurred costs, however, these systems are currently incomplete. As a result, DOE officials rely primarily on memory and individual contract records when making requests. This method has caused inefficient and ineffective contract management, as the following examples illustrate.

In contract 17, DOE officials failed to follow up on a closeout audit request for about 7 years. The contract was for solar power services worth about \$3 million, and it was completed in 1983. DOE requested a closeout audit in 1984, and DCAA acknowledged the request but never conducted the audit. During the interim between DOE's initial request and our review, DOE never followed up to determine why the closeout audit had not been conducted. When asked why they had not followed up on the request, the responsible DOE officials told us they were unaware of the situation. In addition, the officials could not explain a possible overpayment—the difference between costs the contractor claimed and DOE payment records—of \$214,693. Also, the contracting officer initially responsible for the contract at its inception 12 years ago was no longer with DOE to provide information. As of June 1991, DOE officials were attempting to waive the closeout audit because DCAA did not have any post-award audit records and the contractor could not be located. As a result, the potential overpayment may remain unresolved, and DOE lacks assurance that the \$3 million it paid the contractor was for accurate and allowable costs.

In contract 1, DOE officials failed for 3 years to follow up on the submittal by the contractor of its cost accounting disclosure statement.<sup>1</sup> Specifically, DCAA audited the contractor's initial statement in 1988 and

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<sup>1</sup>Cost accounting disclosure statements describe the actual or proposed cost accounting practices, and the audit activity determines the adequacy of the statement and whether the contractor is in compliance with CAS under the terms of the contract.

found it inadequate. DOE, however, lost track of the resulting audit report and did not follow up to ensure that the contractor submitted an adequate statement until our review of this contract 3 years later. An adequate statement still had not been submitted as of July 1991. Furthermore, the DOE official ultimately designated for monitoring the contractor's CAS compliance on behalf of all government contracts did not even know the contractor was subject to CAS audits.

Since the contractor has not submitted an adequate statement, DCAA cannot conduct a CAS compliance audit. The DEAR states that these audits determine whether the contractor is in compliance with CAS and whether any noncompliance has resulted or may result in any increased cost paid by the government. Once noncompliance is identified, the contractor must submit the cost impact on all government contracts. Since DOE has not ensured that the contractor provided an adequate statement, the cognizant audit agency cannot determine if any cost impact under CAS compliance exists.

The cost impacts resulting from CAS noncompliance can be significant. For example, DCAA's CAS compliance reviews for the contractors involved in contracts 7, 8, 9, and 18, respectively, showed total cost impacts of about \$13 million as a result of CAS noncompliance for all government contracts.

In contract 13, CAS compliance audits, according to DCAA, identified numerous instances of noncompliance that affected the costs the contractor claimed. Unlike the four examples above, the full impact of this contractor's noncompliance will not be quantified until the incurred cost audits are performed. For this contract, DOE did not request any incurred cost audits until 4 years after the contract's inception and did not follow up on the request until 1 year later. As of July 1991, no incurred cost audits had been completed for the entire contract period, but DCAA had started the audits and expects to complete most of them within the next few months. From 1985 to 1988, DOE paid about \$21 million for this contract.

Although DOE allows its operations offices and M&Os to develop their own procedures for managing contract audits and obtaining contractor document submittals for the audits, none of the six locations we visited had guidance on all of the audits required and recommended by the DEAR. However, five of the six locations had written guidance on closeout audit requirements. Only one of the five had established target dates for requesting audits or document submittals and for making

follow-up requests. This lack of adequate guidance was also reported by DOE's OIG in 1984 when it visited three DOE operations offices, including San Francisco's. The OIG reported that the offices did not have target dates for the receipt of required documents and did not have follow-up procedures to ensure that the documents were received.

For example, the DEAR requires DOE to request incurred cost audits at least annually for any contract for which the annual cost exceeds \$500,000, or for \$1 million for all contracts. However, two of the DOE operations offices and two of the M&Os did not follow the DEAR requirement for annual requests but primarily relied on DCAA to conduct the audits without requests. However, without such requests, DCAA is not responsible for conducting the audits, according to the memorandum of understanding between DOE and DCAA.

We found that the San Francisco operations office and its M&O contractor—the University of California at the Lawrence Livermore National Laboratory—did not have any written procedures on audit activity, and as a matter of policy, waited until work on the contracts was completed before it made any requests for incurred cost audits. The Oak Ridge operations office had only broad written procedures and no target dates, and as a matter of policy, made only one request for all applicable audits at the contract's inception. It did not follow up to ensure that the cognizant audit agency conducted the audits. At all three locations, the officials responsible for requesting the audits said they did not have time to make requests on a yearly basis.

DOE is also required to obtain from the contractor and submit to DCAA documents necessary to conduct requested audits, according to the DOE and DCAA memorandum of understanding. However, only one of the six locations—American Telephone and Telegraph, the M&O contractor at the Albuquerque operations office's Sandia National Laboratory—had specific procedures for requesting documents and requested them for the contracts we reviewed. In contrast, the other five locations primarily relied on DCAA to obtain the documents. When requests were made, they were not always followed up in a timely manner, as the following examples illustrate.

- For contract 1, DOE did not request for the last 8 years of the contract period (1982-89) documents from the contractor and did not request DCAA to audit the incurred costs. As a result, the contractor's overbilling of about \$1.4 million went undetected for 8 years.

- For contract 12, DOE did not request documents needed for the closeout audit until May 1989, almost 7 years after the contract's completion. When the documents were not provided, DOE did not make a follow-up request until January 1990, 8 months later. The documents still had not been received as of July 1991. As a result, the contract cannot be closed because DCAA cannot furnish DOE with a contract closing statement until appropriate documents are provided.
- For contract 3, DOE had made no attempts to obtain contractor documents necessary for closeout, according to our review. The contractor finally submitted the documents 7 years after contract completion, but DOE misplaced them and did not request them again until 1 year later. As a result, DCAA could not complete a closeout statement until 8 years after the contract was completed.

## DCAA Gives Lower Priority to the Performance of Some Contract Audits

DCAA, the cognizant audit agency for DOE's non-M&O contracts, puts a lower priority on performing some post-award audits, such as incurred cost audits. This lower priority can affect the extent to which contract audits for DOE contracts are performed. According to DOE officials, DOE contracts often receive lower priority for audit coverage because the contracts have smaller dollar amounts than Department of Defense contracts. DCAA officials stated, however, that DCAA's audit priorities for such small-dollar contracts are the same for both DOE and Department of Defense contracts.

According to DOE headquarters procurement officials, contract auditing is resource-intensive and available DCAA staffing to carry out such work has been declining. These officials added that whether DOE contracting officers request an audit on a timely basis or not, such requests will probably not result in a timely audit. This has been the case for many years, according to these officials; contracting officers have known this and have too often not documented in the files requests for audits that were going to go unanswered.

DCAA officials told us that while the timing for conducting incurred cost audits is normally self-initiated, they must be accomplished to facilitate the government's final contract payment to contractors. The incurred cost area is essentially the only area over which DCAA has any control over timing/initiation of audit performance. Therefore, budget constraints impact this area more severely than other areas.

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In December 1990 testimony before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce,<sup>2</sup> GAO reported that DCAA has had backlogs of incurred cost audits for years, in part as a result of increasing work loads during the military buildup of the 1980s, according to DCAA officials. Although DCAA's audit staff has grown, increasing work loads and a hiring freeze produced an increasingly unmet demand for incurred cost audits. For incurred cost audit requests alone, this backlog grew from about \$33 billion in contracts in fiscal year 1981 to nearly \$170 billion in fiscal year 1989.

However, DCAA officials told us that as a result of increased staffing and a decline in preaward audit requests, the growth in the backlog of incurred cost audits has been stopped and some progress made in catching up on prior year audits. The backlog declined to \$161.3 billion at the end of fiscal year 1990. DCAA anticipates that this backlog will be further reduced in the future to an estimated \$138.5 billion by the end of fiscal year 1992.

GAO's December 1990 testimony also concluded that the full resolution of contract audit problems requires the involvement of other federal agencies, as users and suppliers of audit services, and the Office of Management and Budget (OMB), which establishes various audit policies. GAO recommended that (1) the Environmental Protection Agency's Inspector General report the problem of obtaining timely audits of contracts and any progress toward correcting it in the Inspector General's required semiannual reports to the Congress and (2) the Administrator of the Environmental Protection Agency work with other federal agencies, including OMB, to develop ways to expedite audit coverage of contractors.

In June 1991, the Subcommittee issued a report on the activities of the Environmental Protection Agency's Office of Inspector General. This report included not only our December 1990 testimony but recommendations to OMB on contract audit activities. In August 1991 OMB responded to two of the recommendations by creating an interagency task force on contract auditing. The task force's overall goal is to develop recommendations for improving federal contract audit coverage. An immediate objective is to clarify responsibility for audit cognizance and, before the end of October 1991, make recommendations to OMB regarding formal designations. A longer-term objective is to study mechanisms to improve

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<sup>2</sup>EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-RCED-91-5, Dec. 11, 1990).

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the auditing of government contracts, including an analysis of the feasibility and desirability of creating a separate agency to audit such contracts. This study should be completed by the end of March 1992.

In another GAO report,<sup>3</sup> we cited DCAA's audit priorities and work load as being directly influenced by the FAR. DCAA's audit priorities have remained the same since 1982; however, DCAA's work load has increased in each audit component since then, with the incurred cost audit work load increasing more than others because of the large backlog in this area. DCAA policies require auditors to respond to contracting officers' requests for forward-pricing audits—commonly called preaward audits—before addressing other audit components. Preaward audits, which are mainly evaluations of price proposals, are the most time-sensitive requests and normally require less time than other audits. Defective pricing audits are second in priority, followed by incurred cost audits, CAS audits, and other audit-related activities.

Until recently, preaward audits were the largest component of DCAA's audit work load, followed by incurred cost audits. However, incurred cost audits are now the largest component. This shift was not caused by a change in audit priorities but rather by a significant increase in DCAA staff directed toward reducing the backlog of incurred cost audits, which had grown to 13,929 as of January 31, 1990. DCAA has begun to reduce its audit backlog but expects elimination of the backlog to take several years.

DCAA officials told us that DCAA works closely with contract administration organizations to (1) reduce the risk associated with the audit delays through provisional billing rate adjustments and (2) establish priorities for audits that minimize the impact on other contract administration concerns, such as overaged contract controls. According to DCAA, it has been working with components of the Department of Defense to eliminate the large backlog of overaged completed contracts by concentrating its audit efforts on those contractors with the largest number of open overaged cost-reimbursement contracts.

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<sup>3</sup>Defense Contract Audits: Current Organizational Relationships and Responsibilities (GAO/AFMD-91-14, Apr. 3, 1991).

# Objectives, Scope, and Methodology

The Chairman of the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce asked us to (1) determine if the required and recommended contract audits were performed, and if not, why;<sup>1</sup> and (2) identify the impact or potential impact to the government when contract audits were not performed. As part of this effort, we were also asked to obtain information from the OIG on the audit coverage of M&O contractors' allowable costs relative to the annual submission of the M&O contractors' statements on their VANEAS.<sup>2</sup>

We first determined the contract audit requirements by reviewing both the FAR and DEAR. We then decided to focus our non-M&O contract work on cost-reimbursement contracts because contract audits for such contracts should help DOE determine whether (1) it paid a fair and reasonable price for contracts and (2) the contract costs claimed were accurate and allowable.

To determine whether the non-M&O contract audits for monitoring and overseeing the contracting process were performed, we selected a judgmental sample of 19 contracts. Of these, 13 were DOE non-M&O cost-reimbursement contracts and 6 were cost-reimbursement M&O subcontracts that were completed but not closed out.<sup>3</sup> The non-M&O contracts were selected from DOE operations offices in Oak Ridge, Tennessee; Albuquerque, New Mexico; and San Francisco, California. The subcontracts were selected from a principal M&O contractor at each of the operations offices. The M&O contractors were Martin Marietta Energy Systems (Oak Ridge operations office), American Telephone and Telegraph (Albuquerque operations office), and the University of California (San Francisco operations office). These three contractors accounted for \$5 billion (over one-third) of the \$13.8 billion obligated to the M&O contractors in

<sup>1</sup>The FAR and DEAR identify the various types of audits required and recommended or suggested. For example, incurred cost and indirect rate audits are required while operational audits, such as timekeeping procedures, are recommended.

<sup>2</sup>This report primarily focuses on the use of contract audits and related activities by DOE's operations offices and the audit activities of the OIG. In the past, DCAA performed most of the audit services for DOE's non-M&O prime contracts and subcontracts. DCAA's responsibility for these services expanded to include audits of all DOE non-M&O prime contracts and subcontracts as of Jan. 1, 1991. The memorandum of understanding that formalized this arrangement was signed by DOE and DCAA officials in Sept. 1991. An examination of DCAA's contract audit management was beyond the scope of this report. Where appropriate, however, we included DCAA information to illustrate various problem areas.

<sup>3</sup>As of Sept. 30, 1990, DOE had about 1,300 non-M&O cost-reimbursement contracts that had been completed but not closed out. DOE did not have summary information on the number of cost-reimbursement M&O subcontracts that had been completed but not closed out.

fiscal year 1990. Because we judgmentally selected the 19 contracts, the findings cannot be projected to the universe of contracts.

Our sample of 19 non-M&O contracts included (1) a mixture of contracts of high and low dollar value and (2) contracts that had been completed the longest time without being closed out. However, we did include some contracts that had been completed more recently to have a broader range of coverage. Total obligations for these 19 contracts were about \$228 million. By selecting completed but unclosed contracts, we believed that sufficient time should have elapsed for the full range of contract audit activity to have occurred for each contract. For each of the selected contracts, we performed a detailed review to document from the contract files, closeout files, and other sources, such as DCAA information, the extent of contract audit activity involving each contract and the contractors overall.

To identify the impact or potential impact to the government when non-M&O contract audits were not performed, we used the results of our detailed contract reviews. These reviews focused not only on whether the contract audits were performed and when they were performed but also on discrepancies between the amount DOE paid and the amount the contractor claimed. These reviews also documented the extent of DOE actions to request audits and DOE's associated follow-up activities and monitoring efforts. In performing this contract review work, we relied on information in DOE's and the M&O contractors' files and discussions with DOE and M&O contract administration officials about their activities and actions regarding the performance of contract audits. In addition, we contacted DCAA officials having contract audit responsibility for our selected contracts to (1) discuss the contract audit history involving the contractor and our specific contract and (2) obtain any relevant documents concerning our selected contracts that were not in DOE's files.

In our contract review work, we only included data for operational audits, CAS reviews, and estimating system reviews, if the audits were conducted during the time the contracts we reviewed were in effect. We made this decision because these audits involve a review of the contractor in general. If these audits were not performed during the period of the contract, they would have no effect on the contract we reviewed. If we found no evidence that these audits were performed during the contract period reviewed, we documented, in table II.1, our contract as "none identified" for these audits.

To obtain information on the audit coverage of M&O contractors' allowable costs relative to the annual submission of the M&O contractors' statements on their VANEAS, we interviewed DOE OIG officials at DOE headquarters in Washington, D C.; the Western Region in Albuquerque, New Mexico; and the Eastern Region in Oak Ridge, Tennessee. We also reviewed the OIG's semiannual reports to the Congress, which describe the VANEAS audit coverage; audit reports on M&O contractors' internal controls to ensure that costs claimed and reimbursed were allowable; VANEAS statements; and the OIG's 5-year plan for auditing M&O contractors' allowable cost representations. We did not assess the adequacy of the OIG's 5-year plan. We also discussed with OIG officials the extent to which the M&O contractors' internal auditors have performed required allowable cost audits.

As previously discussed, a detailed examination of DCAA's contract audit management was beyond the scope of this review. Similarly, for purposes of this review, we did not evaluate DCAA's audit priorities and audit work load. We do have, however, other recently completed work that has addressed DCAA's audit priorities and audit work load.<sup>4</sup> We relied on this recent work and confirmed in a mid-August 1991 meeting with DCAA officials that the issues raised in the previous testimony and report still exist today.

We conducted our review between July 1990 and September 1991 in accordance with generally accepted government auditing standards.

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<sup>4</sup>EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-RCED-91-5, Dec. 11, 1990) and Defense Contract Audits: Current Organizational Relationships and Responsibilities (GAO/AFMD-91-14, Apr. 3, 1991).

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