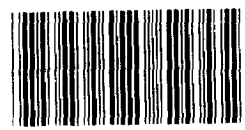


~~16084~~

114301



UNITED STATES GENERAL ACCOUNTING OFFICE
DALLAS REGIONAL OFFICE
1114 COMMERCE STREET, ROOM 507
DALLAS, TEXAS 75242



114301

FEB 04 1981

Letter on form #103

Colonel William L. Walker
Commander
Defense Contract Administration
Services Region, Dallas
500 South Ervay
Dallas, Texas 75201

Dear Colonel Walker:

We have completed our examination of selected provisional payments under contracts administered by the Defense Contract Administration Services Region (DCASR), Dallas. This letter summarizes the results of our examination and recognizes the corrective actions you have taken.

We believe your actions will aid in protecting the Government's interests in this region and, accordingly, we are not making any formal recommendations. However, we believe control over provisional payments should be of concern to all the DCASRs and are therefore arranging for further distribution of this report to alert other regions to potential control problems.

Previously, we called to your attention the results of our examination of specific payment vouchers, which disclosed, or led to the disclosure of, instances in which

- contractor records had apparently been altered and information added after the fact to support charges,
- labor was billed for periods before the tasks were authorized in the contract and/or after the tasks were terminated,
- general and administrative expenses were double billed,
- purchase discounts were not passed on to the Government,
- the Government paid a contractor over \$60,000 for materials not yet acquired (DCASR inspectors, following up on GAO's findings, found additional premature payments of \$100,000),

Group III Letter Report

(950594)

015 240
114301

--the Government paid a contractor over \$30,000 for manufacturing parts; however, the contractor had not acquired all the materials necessary to make the parts. Further, a DCASR inspector approved the bill and "accepted" the parts, knowing they had not been completely manufactured, and

--a contractor misclassified purchases of equipment and consultant labor as direct materials, thereby obscuring the composition of total contract cost and increasing the likelihood that Government-owned/furnished equipment would not be properly controlled.

In conducting our work we visited your regional office in Dallas and your management area offices in Dallas and San Antonio to examine the procedures and controls related to provisional approval of contractor reimbursement vouchers. We met with responsible officials and reviewed regulations and supporting documentation pertinent to payments on several contracts.

Additionally, we visited three contractors to examine supporting documentation for selected vouchers billed to the Government. You have informed us that certain information developed on contracts held by two of these contractors has been referred to appropriate authorities for investigation of possible violations of criminal law. Since the investigation results are not yet known, we have omitted contractor names and contract numbers from this report. We also visited officials in the procurement agencies that awarded these contracts and auditors in the Defense Contract Audit Agency (DCAA) to discuss the results of our examination as it related to their agencies.

As discrepancies were called to your attention, you and your staff took immediate action on specific instances and also developed management changes to reduce their occurrence. Actions taken included

--dismissing a Government inspector for accepting parts before they were manufactured,

--sending a demand notice to one contractor to repay about \$100,000 (plus interest) that was paid prematurely,

--making a complete review of purchase orders on two contracts to identify all equipment items charged to the Government as direct materials,

--appointing a special task force to review controls and procedures used to process and pay reimbursement vouchers, and

introducing specific guidelines now in draft form, standardizing the actions of administrative contracting officers to assure that proper payments are made to contractors for contractor-acquired property (IAP). This issue is passed to the Government prior to payment.

When properly implemented these management changes, we believe, will improve the procedures and controls employed to process contractor reimbursement vouchers.

The large number of Department of Defense (DOD) contracts and their enormous dollar value dictate that contract administrators must be ever-vigilant in controlling costs and assure correct payments. As of July 1980, Defense Contract Administration Services (DCAS) was administering about 150,000 contracts, valued at over \$85 billion. Cost-type contracts accounted for over 60 percent of that amount. DCASR billings' approximately 10,000 contracts were valued at about \$1.5 billion. 80 percent of them involved cost-type contracts.

In cost-type contracts, and fixed-price contracts with reimbursement features, contractor billings are provisionally approved and paid subject to later audit by the Defense Contract Audit Agency (DCAA). Depending on how the contracts are written, the billings may be approved by either DCASR or DCAA, but in either case, the administrative (or contracting) officer (AO) is responsible for assuring the reasonableness of costs incurred and should review paid vouchers to ensure the adequacy of the contractor's overall contract management, cost control, and performance.

To fulfill their responsibilities, AOs rely heavily on the contractor's integrity and the reserved right of post audit to protect the Government's interest. In the future, we believe, the funding activity, administering officials, and designated contract auditors should better coordinate their efforts to protect the Government's interest. Further, administrative contracting personnel should provide more comprehensive contract management or monitoring costs while the work is actually being performed. These actions, in our opinion, will help prevent, or provide earlier detection of, overpayments and errors in billings. Details of our examination and findings are presented in the following paragraphs.

Need for better coordination between funding, administering, and auditing activities

For the time and materials contract we examined, the AO was the approving official for provisional payments. Normally DCAA is the contracting officer's authorized representative for examining contractor

reimbursement vouchers. However, although all required work on this contract had been completed at the time he started his audit, he did not know the contract had been awarded or that payments had been provisionally approved by the AIC. Early DCAA involvement, he believed, would have detected reimbursement problems.

The contract provided that work on various tasks could not begin until specifically authorized in writing by the contracting officer. However, records show that although the task was authorized April 10, 1973, the contractor billed the Government for about \$1.5 million before that date. Some of the time charges dated as far back as November 1972 and even predated the authorization of the entire task. Contractor officials stated that some billings were prepared late before time cards and other accounting system data could have supported the amounts billed. He stated that receipts may have been used and/or altered to support the amounts billed.

Also, when buying several major equipment items the contractor took advantage of material discounts, but billed the Government the higher, nondiscounted prices. The contract clearly stated that material discounts should be passed on to the Government.

The AIC informed DCAA of IAO's findings and asked them to audit the contractor. In its report to the AIC, DCAA confirmed IAO's findings and reported that data the contractor had provided to support the provisional payments had been prepared after the fact, and that information taken from the records could not be relied upon because there were indications that records had been added to or altered. Also, time cards, task orders and invoices did not relate the materials purchased to the tasks performed. DCAA concluded that since the contractor had failed to maintain adequate supporting documents for the costs claimed, it would be impossible to determine the actual cost of performing the contract.

The AIC had been approving provisional payments on this contract, relying on the programming office and the contractor's integrity to ensure cost control. He said a cost-aware conference had not been held because the contractor had a good reputation. DCAA auditors said as a matter of fact, that if they had been consulted their bills would have warned the AIC that this contractor had submitted similar artificial billings on other contracts. DCAA officials also said that because of IAO's inquiry, they provided the in-house audit coverage needed to disclose the billing abuses found.

The Air Force activity that awarded the contract was requesting copies of the contractor's bills, but the reviewing official assumed that either the AIC or DCAA was actually monitoring billed costs. The reviewing official said he was interested only in the contractor's performance and had no intention of participating in the accuracy and validity of billed costs.

In summary, we found that during the active life of this contract everyone was relying on someone else to monitor costs when, in fact, no one was doing so. As the DCAA auditors pointed out, it is extremely difficult to reconstruct costs after work has been performed. The ACO said that in the future he would bring DCAA into the approval and review process much sooner, and that costs would be actively monitored during the period of actual contract performance.

Need for more intensive management

We examined vouchers submitted by another contractor under firm fixed price, overhaul and maintenance contracts with material reimbursement features. Our review disclosed payments (1) based on inadequate substantiating documents and (2) for contractor-acquired or -manufactured parts which, at the time of payment, had been neither acquired nor manufactured.

The contractor was billing the Government based on pro forma invoices or his own purchase order, but sometimes waiting long periods (in one case over 9 months) to make purchases. The Government, then, was prematurely paying the contractor for materials to which neither the contractor nor the Government could claim title.

On another occasion the contractor billed the Government for items they had not yet manufactured--in fact the contractor had not even received several of the raw materials needed to manufacture the items. A DCASR official accepted the items on the Government's behalf at a time when the items could not possibly have been completed and ready for use. DCASR officials told us the inspector had admitted signing a false receiving report but said the fact that contractor personnel had previously threatened other Government employees may have intimidated him into signing the report.

In addition to paying the contractor for materials neither purchased nor manufactured, the Government was also paying an across-the-board, 15-percent material handling charge on direct material purchases. The charge, according to the contractor, was arbitrarily established in an agreement with the ACO and was not based on historical cost or other accounting data. The ACO had negotiated the handling charge without the benefit of a financial analysis by DCAA. However, on a prior occasion DCAA had advised DCASR that material handling charges should not be allowed because (1) the contractor's accounting system did not provide for these charges as a separate item of cost and (2) these charges are included in overhead; allowing a separate charge would result in a double charge for this item.

DCASR officials stated that the ACO was acting within the scope of his authority when he negotiated the material handling charge. We recognize an ACO's authority to negotiate a handling charge, but believe such charges should be both verifiable and reasonable. In one instance, the contractor billed the Government in July 1979 for \$28,980 as reimbursement for \$25,200 in materials, plus a 15-percent material handling charge of \$3,780. The contractor's voucher was approved by the ACO and paid by the Government in early August. The contractor, however, did not purchase the materials until May 13, 1980, over 9 months later. In effect, the contractor was paid a handling charge of almost \$4,000 on materials not purchased.

The ACO had also closed contracts without a DCAA post-audit of provisionally approved payments. In July 1978 DCAA provided the ACO with a list of about 30 contracts with this contractor, which had not been audited. DCAA asked the ACO to call them which contracts to audit, and said they would consider waiving audit on the others. The ACO responded that he contemplated requesting an audit on only two of the contracts. He said that three of the contracts had already been closed without audit and requested that audit be waived on the remaining contracts. The three contracts that had been closed without audit were among the largest contracts on the list (provisional payments on one exceeded \$2 million).

In another instance, the ACO stilled an attempt by DCAA to audit the contractor. In June 1978 DCAA initiated an audit and subsequently asked the contractor to provide supporting invoices for payments that had been provisionally approved. The contractor told DCAA that all necessary information had already been provided to the ACO. The ACO told DCAA that he had negotiated an agreement with the contractor, which stated that material prices invoiced by the contractor for materials would be considered firm, fixed prices, and that no audit was necessary. The negotiation agreement, however, was dated July 1978—a month after DCAA initiated their closing audit. DCASR officials told us that the ACO had acted within his legal authority closing a contract without audit, but admitted that he had probably used poor judgment in this case.

DCASR has taken action to correct these deficiencies, including asking DCAA to reexamine the validity of the material handling charge and removing a Government Inspector from duty for accepting parts before they were completed. Also, DCASR has appointed a Board to review controls and procedures over reimbursement vouchers, and is writing guidelines to ensure the Government's interest is protected before paying a contractor on the basis of an unexecuted purchase order or pro forma invoice. DCASR believes that premature payments are, in effect, interest free loans and has recently demanded that this contractor repay the Government \$100,000 paid in May 1980 for material that will not be

shipped to the contractor until June 1981. Additionally, the contractor is required to pay a "free use" charge of over \$5,000. This charge will continue, at a rate of interest set by the Treasury, until the Government is reimbursed.

Classification of contract costs

On one cost-type contract we examined, the contractor repeatedly billed and was reimbursed for direct materials which our examination disclosed were actually purchases of consultant labor and equipment. The contractor said that procuring activity officials were aware of these purchases and maintained there was no economic harm to the Government from the misclassification of expenses. Procurement officials agreed. However, since the contract did not provide for using consultants or Government furnished equipment, we believe charging these costs to direct materials obscured the true nature of the total contract costs.

Additionally, some of the equipment items purchased and charged as direct materials were not properly recorded as Government furnished equipment (GFE) and may not have been readily identifiable as available for use in other contracts or for return to the Government. Several equipment items had been charged off as direct materials on two different contracts, one completed in 1975 and the other in 1976. An inventory of several items revealed no discrepancies but disclosed that, except for a computer and keypunch machine, none of the equipment was in use.

Initially, contractor personnel could not tell us which contract the computer and keypunch machine were being used for. Later, we were provided information showing that these items were among GFE on a contract not administered by DCAS. This contract, awarded in 1973, is about to be closed out and the contractor has requested the purchasing activity to transfer the equipment to another contract. However, contractor officials could not tell us the status of the equipment between 1975 and 1978.

DCASR officials said that the equipment purchases described above occurred prior to June 1978, before a contractor procurement system review revealed major deficiencies requiring that system approval be withheld. The deficiencies were corrected and the contractor's system was subsequently approved. However, the contractor informed us that he still charges the purchase of equipment and labor as direct materials. Your staff, we understand, is reviewing contractor purchase orders reimbursed by the Government so that all equipment items can be identified and properly accounted for.

- - - - -

As stated earlier, we discussed our findings with you and/or members of your staff throughout the period of our review and there appears to be

general agreement with the issues raised, such as the need for cost monitoring during actual contract performance and better coordination between the funding activity, administering officials, and contract auditors.

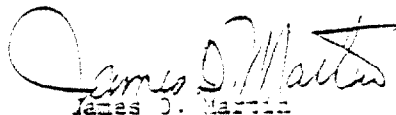
Concerning the need for better coordination and communication between the funding activities and DCAS administering officials, you pointed out that prior to our review Dallas DCASR had developed and initiated a program known as Advanced Contract Administration Assistance as a mechanism to encourage such coordination. The program points out the need for preaward coordination between the procurement personnel and the contract administration personnel to reduce problems, such as

- ambiguous contract terms,
- questions of authority/responsibility, and
- quality/inspection requirements.

Offering preaward coordination does not assure that procurement offices will accept it, but we believe it is a step toward improved communications.

We appreciate the cooperation Dallas DCASR officials extended to our representatives. For the most part, we believe we encountered concerned employees with a genuine desire to improve administrative controls.

Sincerely yours,


James J. Martin
Regional Manager

JDM:dcd