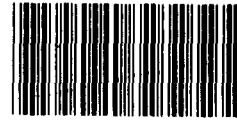


May 1992

CONTRACT PRICING

DOD's Audit Follow-up System Is Inaccurate and Incomplete



146777

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**National Security and
International Affairs Division**

B-242859

May 28, 1992

The Honorable John Glenn
Chairman, Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report is one in a series being issued in response to your request that we evaluate the adequacy of controls for preventing fraud, waste, and mismanagement in Department of Defense (DOD) subcontract pricing. It deals with DOD's audit follow-up system coverage of cost-estimating reports issued by the Defense Contract Audit Agency (DCAA). Our objective was to determine if DOD's audit follow-up system provides DOD managers with reliable information so that they can oversee the progress contractors make in correcting cost-estimating system deficiencies.

Background

A sound contractor cost-estimating system is a major control for ensuring fair and reasonable noncompetitive contract prices. In March 1988, in response to evidence of contract overpricing, DOD revised its regulation that requires major contractors to establish, maintain, and disclose adequate cost-estimating systems. The regulation provides that DCAA, along with contract administration personnel, regularly audit (generally every 3 years) the adequacy of contractor estimating systems. According to DOD, the revised regulation represents its most significant action for ensuring that contractors' proposals include all the information necessary to establish fair and reasonable prices.

One of DOD's primary management tools for determining whether contractors correct cost-estimating system deficiencies is its audit follow-up system. DOD's audit follow-up system—required under DOD Directive 7640.2¹—provides DOD management and the Congress with oversight information on whether contracting officers are obtaining timely corrective action on audit recommendations.¹ DOD administrative

¹The design of the audit follow-up system provides oversight primarily of the progress made by administrative contracting officers in meeting resolution and disposition target dates for cost-estimating system reports. It does not distinguish between adequate and inadequate cost-estimating systems or show the number, type, or significance of deficiencies.

contracting officers² must track and report all cost-estimating system reports into the system that contain findings and recommendations.

DOD Directive 7640.2 requires the DOD Inspector General (IG) to monitor the timely resolution and disposition³ of audit reports, such as DCAA reports on cost-estimating systems, defective pricing, and overhead audits. The DOD/IG presents information from the audit follow-up system in semiannual reports to the Secretary of Defense and the Congress.

DOD managers also use data from the audit follow-up system to brief the Congress on the status of audit findings. For example, in May 1991, the Director, Defense Procurement, used data from the system in a testimony before the Senate Committee on Governmental Affairs. The Director stated that deficiencies in 92 percent of 555 estimating system reports had been resolved in a timely manner. The Director also stated that

The audit follow-up system currently used to track the status of outstanding audit recommendations already provides management with necessary insight into both prime contractor and subcontractor pricing problems reported by GAO, the IG, and DCAA. All audit reports with findings and recommendations—including defective pricing audits and estimating system surveys—are tracked until resolved and dispositioned.

Because the audit follow-up system is a key component of DOD's oversight over contractors with pricing problems, we evaluated the March 1991 audit follow-up system data base to determine whether it accurately reflected the status of cost-estimating system findings contained in reports on 49 contractors. We selected the 49 contractors because DCAA identified them in fiscal year 1991 as "high-risk" contractors due to their chronic estimating system deficiencies.⁴

²Most of DOD's administrative contracting officers are employed by, and are responsible to, the Defense Contract Management Command, Defense Logistics Agency.

³The DOD directive contains extensive definitions of the terms "resolution" and "disposition." In brief, it defines resolution as including "the point at which the audit organization and contracting officer agree on the action to be taken on audit report findings and recommendations" Disposition is achieved, when among other things, "the contractor implements the audit recommendations" or when prior "audit reports have been superseded by or incorporated into, a subsequent report." The Office of the DOD/IG considers the term "implement" to mean that the action required to correct the deficiency cited in the audit report has been completed.

⁴DCAA's list of high-risk contractors contained 52 contractor corporate divisions. The 49 contractor divisions discussed in our report are those for which DCAA had issued cost-estimating system reports. DCAA had not issued any reports on the remaining three contractor divisions. The 49 divisions are related to 35 contractors. When conducting a cost-estimating system review, DCAA considers each division as a separate entity. Therefore, throughout this report we use the term "contractor" when referring to the divisions subject to a DCAA report.

Results in Brief

DOD managers are provided inaccurate and incomplete information on the condition of contractors' estimating systems and on the contractors' progress in correcting system deficiencies. For 71 percent of the contractors that DOD designated as high risk, DOD's audit follow-up system was either missing reports, understated the length of time deficiencies had remained uncorrected, or showed that contractors had completed corrective action when they had not. DOD managers should have accurate and complete data for all contractors, but it is particularly important for the high-risk contractors that DCAA has already determined pose the greatest risk of contract pricing problems.

Reports are not included in the follow-up system, in part, because of administrative contracting officers' decisions about whether (1) an audit report should be in the follow-up system or (2) the contractor has adequately responded to audit recommendations. The age of outstanding deficiencies is understated because audit follow-up system procedures require current reports to supersede earlier reports even though the earlier deficiencies have not been corrected.

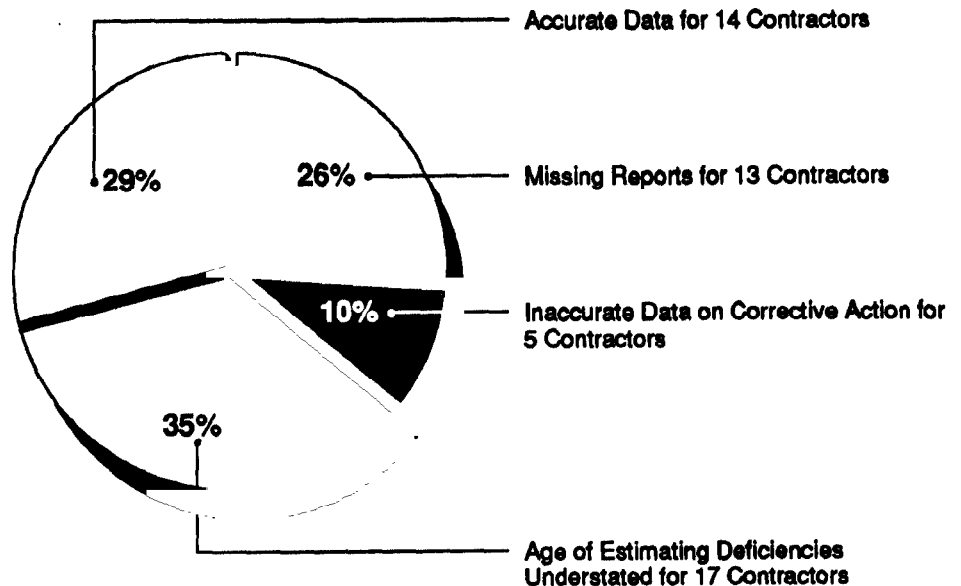
DOD has proposed changes or recently taken action to improve its audit follow-up system. While we believe these actions will address many of our concerns and improve the follow-up system, DOD's administrative contracting officers still need to address some of the problems discussed in this report.

DOD's Audit Follow-up System on Contractor Cost-Estimating Systems Is Inaccurate and Incomplete

DOD's audit follow-up system data was inaccurate or incomplete for 35 of the 49, or 71 percent, of the high-risk contractors. In fiscal year 1990, the 35 contractors had an estimated \$17.5 billion in DOD contracts.

The follow-up system data was inadequate in three areas. The system (1) was missing reports on 13 contractors, (2) understated the length of time cost-estimating deficiencies remained uncorrected for another 17 contractors, and (3) showed 5 contractors had corrected deficiencies, when our review showed they had not. (See fig. 1.)

Figure 1: Follow-up System Had Inadequate Data in Three Areas



Missing Reports

According to DOD Directive 7640.2, the follow-up system should include all estimating reports with findings and recommendations. Yet cost-estimating reports for 13 contractors were missing from the system. The following data describe two of the reports missing from the system.

- DCAA issued an estimating system report in February 1991 concluding that a contractor's estimating system was generally adequate; however, DCAA noted that four deficiencies identified 28 months earlier still required corrective action. DCAA noted that it could place more assurance on the contractor's proposal estimates once the contractor corrected these deficiencies. DOD's audit follow-up system contained no information on this report.
- A February 1991 estimating system report concluded that a contractor's estimating system was partially inadequate. This was due to an estimating system deficiency that caused DCAA to reject as unauditible, two of five contractor proposals and to question about \$1 million, or 15 percent, of the remaining three proposals' costs. DOD's audit follow-up system contained no information on this report.

We contacted the administrative contracting officers responsible for the 13 contractors whose reports were not in the system.⁶ They stated the following reasons for not including reports in the follow-up system: (1) DCAA had scheduled follow-up audits, (2) the procurement contracting officer or DCAA would monitor future proposals for overpricing, and (3) the cost-estimating deficiencies in the report were too minor to track and report. DOD requirements, however, do not recognize any of these reasons as valid. Such decisions by administrative contracting officers limit visibility over contractors' cost-estimating system deficiencies cited in the missing reports, and the progress being made to correct them.

Age of Cost-Estimating Deficiencies Understated

According to DOD Directive 7640.2, disposition of an audit report is achieved in several ways, including when a subsequent report is issued. According to the Office of the DOD/IG, the directive includes this provision because tracking the initial results of certain type of audits, such as overhead and defective pricing, is not needed when follow-up reports are issued. However, for estimating system audits, this requirement causes the audit follow-up system to lose the date when DCAA first reported the uncorrected cost-estimating deficiencies. This can result in erroneous conclusions regarding the timeliness of the contractor's corrective actions on the deficiencies.

Superseding previous reports was the primary reason the audit follow-up system overstated the progress made by 17 contractors in correcting estimating system deficiencies. The 17 DCAA reports showed previously identified deficiencies remained uncorrected for an average of 32 months. The audit follow-up system, however, showed that the deficiencies were outstanding for only 9 months. The following examples show that the audit follow-up system does not accurately report the length of time estimating system deficiencies remain uncorrected.

- In a report issued in September 1990, DCAA described a high-risk contractor's estimating system as partially inadequate and found that four deficiencies identified in two previous reports (issued in June 1987 and January 1989) remained uncorrected. DOD's audit follow-up system showed the deficiencies had been outstanding for 6 months rather than the 45 months the deficiencies were actually outstanding.

⁶One DCAA report assessed the cost-estimating systems for two contractor divisions. Thus, DCAA reviewed the estimating systems of 13 contractor divisions in 12 reports.

-
- In a February 1990 report on another high-risk contractor with a partially inadequate cost-estimating system, DCAA cited 18 cost-estimating deficiencies identified earlier in a September 1989 report (2 of those had been cited in a 1984 report). DCAA concluded that a substantial portion of the \$11 million in questioned, unsupported, and unresolved costs—about 10 percent of the costs proposed by the contractor—would have been avoided if the contractor had a sound estimating system. DOD's audit follow-up system showed the two deficiencies were outstanding for 13 months rather than the 81 months the deficiencies were actually outstanding.

We contacted 8 of the 17 administrative contracting officers responsible for reports that showed previously identified deficiencies remained uncorrected. For seven of the eight reports, the administrative contracting officer used the follow-up reports issued by DCAA as the basis for the disposition or closing of the report. All seven complied with the requirement to supersede the initial report and cited it as the reason for dropping DCAA's initial report. In the eighth case, DCAA's initial report was missing from the system, therefore, we could not determine if the administrative contracting officer had closed the report.

Corrective Actions Inaccurately Shown

According to DOD Directive 7640.2, disposition of an audit report is also achieved when the contractor implements the audit recommendations. According to the Office of the DOD/IG, a contractor corrective action plan addressing DCAA's audit recommendations, but without implementation of the plan or only partial implementation of a plan addressing DCAA's audit recommendations, is not sufficient to support disposition. We found, however, that administrative contracting officers had assigned a disposition classification to five reports even though the contractors had not implemented or had only partially implemented DCAA recommendations to correct cost-estimating deficiencies. For example, in November 1989, DCAA reported that a contractor had an estimating system that was inadequate in some respects. Based on audits of 50 proposals, DCAA questioned \$154 million in proposed costs. DCAA also noted in its report that seven deficiencies it had identified 28 months earlier still required corrective action. In June 1990, the administrative contracting officer dispositioned the report because he was satisfied with the contractor's corrective action plan. However, in September 1991, DCAA reported that while the contractor had corrected four deficiencies, it had not totally resolved three of the seven deficiencies identified in earlier DCAA reports.

Recent Actions on DOD's Audit Follow-up System

During our review, a DOD Process Action Team proposed several changes to improve the accuracy and completeness of the data in the audit follow-up system. For example, the Process Action Team proposed that DCAA electronically transfer the report numbers of issued audit reports to administrative contracting offices at monthly intervals. According to DOD officials, transferring the report numbers would reduce the number of missing audit reports.

Also, the DOD/IG has recently taken action to assure that the audit follow-up system contains information on when DCAA initially reported cost-estimating system deficiencies. The DOD/IG plans to add this date to reports in the follow-up system. In the future, the audit follow-up system will include the date of the report that contains the oldest issue still open. In addition, the DOD/IG will annotate the follow-up system to show DCAA reports that recommend partial or complete disapproval of the contractor's estimating system.

These changes to the audit follow-up system should provide DOD managers with more reliable information on the status of individual audit reports. However, in addition to the proposed changes, administrative contracting officers need to better ensure that contractors complete action adopting audit recommendations before the contracting officers disposition audit reports.

Recommendation

We believe the importance of accurate audit follow-up reporting for effective management oversight of cost-estimating deficiencies and the associated risk of overpricing where cost-estimating weaknesses exist, warrant further DOD action. We also believe that the measures proposed by the DOD Process Action Team will, when implemented, improve the information provided by the audit follow-up system. However, we believe additional action is necessary to address the problem of reports that are prematurely dispositioned from the system.

Therefore, we recommend that the Secretary of Defense direct the Director of the Defense Logistics Agency to ensure that administrative contracting officers verify that contractors have corrected all deficiencies cited in DCAA audits of cost-estimating systems before reporting disposition of the audit.

Agency Comments and Our Evaluation

In commenting on this report, DOD concurred with the recommendation and four of the five findings, and partially concurred with the other finding. (See app. I.) In partially concurring with the finding that 12 cost-estimating system reports were missing from the follow-up system, DOD stated that although a number of audits should have been reported pursuant to the requirements of DOD Directive 7640.2, appropriate follow-up actions are being taken on the open issues, which is the major objective of the contract audit follow-up program.

We agree it is important that DOD administrative contracting officers take appropriate follow-up action on audit report findings and recommendations. However, if those report findings and recommendations are not included in the follow-up system, the system cannot provide the data needed to allow DOD management and the Congress to properly oversee the timely correction of contractor deficiencies. We believe it is important that DOD comply with its regulations and report all relevant audit reports so that DOD can ensure that appropriate follow-up action is taken in a timely manner.

Scope and Methodology

To test the completeness and accuracy of DOD's audit follow-up system, we used DCAA audit reports on the 49 contractor divisions DCAA identified in its fiscal year 1991 defective pricing program as having chronic estimating system deficiencies. We used reports issued prior to March 31, 1991, to determine whether the audit follow-up system provided accurate and complete information on contractors' estimating systems. While the follow-up system contained several hundred DCAA reports on estimating systems, we believed it was reasonable to expect that the system would track reports on high-risk contractors.

The DOD/IG provided us with the audit follow-up listings for these contractors that it had compiled for the 6-month periods ending March 31, 1991, September 30, 1990, and March 31, 1990. We relied on the DOD/IG Contract Audit Follow-up Unit to produce the printouts from the DOD/IG's automated audit follow-up system and to verify whether three DCAA reports were in the pre-automated system used before 1990. We prepared and analyzed a data base that incorporated both the DCAA reports and the semi-annual DOD/IG listings.

We reviewed the DOD Directive 7640.2, Defense Federal Acquisition Regulation Supplement 215.811/("Estimating Systems"), and related DOD guidance on audit follow-up activities. We interviewed DCAA, Defense

Logistics Agency, DOD/IG, and contract administration officials about their follow-up system review activities. We made our review between June 1991 and March 1992 in accordance with generally accepted government auditing standards.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time, we will send copies to the Secretary of Defense; the Director, DCAA; the DOD/IG; and the Director, Defense Logistics Agency. Copies will also be made available to other interested parties.

Please contact me at (202) 275-8400 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix II.

Sincerely yours,



Paul F. Math
Director, Research, Development, Acquisition,
and Procurement Issues

Comments From the Department of Defense

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



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OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

APR 20 1992

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

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled--"CONTRACT PRICING: DoD's Audit Follow-up System is Inaccurate and Incomplete," dated March 20, 1992 (GAO Code 396690/OSD Case 8977). The Department only partially agrees with the report.

The Office of the Inspector General, DoD, conducted a review of 12 reports the GAO indicated were missing from the DoD contract audit follow-up system. It was determined that Administrative Contracting Officers were taking action on the audit report findings and recommendations, even though they had not reported all of them in the DoD follow-up system. The Department concluded that, although a number of the audits should have been reported pursuant to the requirements of DoD Directive 7640.2, appropriate follow-up actions are being taken on the open issues, which is the major objective of the follow-up program.

On July 1, 1990, the Defense Contract Audit Agency commissioned a Process Action Team to evaluate the DoD process for transmitting information on reports requiring follow-up. One of its recommendations was to transmit the required data using electronic media. The electronic transfer of such data is expected to begin in January 1993. Implementation of the Team recommendations and refinements to the Defense Contract Audit Agency Management Information System should greatly increase the accuracy of the transmitted data at a substantial reduction in effort, and provide DoD managers with more reliable information on the status of individual audit reports.

Appendix I
Comments From the Department of Defense

The detailed DoD comments on the report findings and recommendation are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,



Eleanor R. Spector
Director, Defense Procurement

Enclosure

Appendix I
Comments From the Department of Defense

GAO DRAFT REPORT--DATED MARCH 20, 1992
(GAO CODE 396690) OSD CASE 8977

"CONTRACT PRICING: DOD'S AUDIT FOLLOW-UP SYSTEM
IS INACCURATE AND INCOMPLETE"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

FINDING A: Contractor Cost Estimating System. The GAO reported that a sound contractor cost-estimating system is a major control for ensuring fair and reasonable non-competitive contract prices. The GAO explained that, in March 1988, the DoD revised the regulation that required major contractors to establish, maintain, and disclose adequate cost-estimating systems. The GAO further noted the revised regulation provided that the Defense Contract Audit Agency (along with contract administration personnel) regularly must audit the adequacy of contractor cost estimating systems. The GAO commented that the revised regulation was the most significant action taken by the DoD to ensure that contractor proposals include all the information necessary to establish fair and reasonable prices.

The GAO observed that the DoD audit follow-up system provides management and the Congress with oversight information on whether contracting officers are obtaining timely corrective actions on audit recommendations. The GAO noted that DoD administrative contracting officers must track and report all cost-estimating system reports that contain findings and recommendations. The GAO reported that the DoD Inspector General monitors the timely resolution and disposition of audit reports on cost estimating systems, defective pricing, and overhead audits. (pp.1-4/GAO Draft Report)

DOD RESPONSE: Concur.

FINDING B: DoD Audit Follow-up System on Contractor Cost Estimating Systems is Inaccurate and Incomplete--Missing Reports. The GAO found that cost-estimating reports for 13 contractors were missing from the DoD audit follow-up system because (1) the Defense Contract Audit Agency had scheduled follow-up audits, (2) the procurement contracting officer or the Audit Agency would monitor future proposals for overpricing, and (3) the cost-estimating deficiencies in the report were too minor to track and report. The GAO noted,

Enclosure

Now on pp. 1-3.

however, that the cited reasons represented decisions made by Administrative Contracting Officers and were not recognized by the DoD as valid. The GAO concluded that such decisions by Administrative Contracting Officers limit visibility over deficiencies in contractor cost-estimating systems cited in the missing reports--as well as the progress being made to correct them. (pp. 5-6/GAO Draft Report)

Now on pp. 4 and 5.

DOD RESPONSE: Partially concur. The Office of the Inspector General, DoD, requested information on 12 estimating system survey reports involving 13 contractors missing from the audit follow-up system. (One of the audit reports covered the review of two divisions under one contractor.) The responsible Administrative Contracting Officers and several Defense Contract Audit Agency auditors were contacted to verify the status of corrective actions on each report. That review disclosed the following:

See comment 1.

- One audit report was actually included in the contract audit follow-up system, although it was reported incorrectly due to a data entry error. However, the Administrative Contracting Officer is tracking and reporting the open estimating system deficiencies and conditions.
- Three of the reports were "flash reports" relating to specific pricing proposals and, as such, are nonreportable. The estimating deficiencies cited in the reports should have already been acted upon by the Procuring Contracting Officers during proposal negotiations. Recurring estimating deficiencies would be addressed in comprehensive estimating system survey reports issued to the Administrative Contracting Officers, and would be tracked in the contract audit follow-up system.
- Two of the reports were reportable follow-up estimating system surveys that were excluded from the contract audit follow-up system. However, the open estimating system deficiencies and conditions currently are being tracked and reported under two other audit reports.
- Three reports were not entered into the contract audit follow-up system as a result of documented Administrative Contracting Officer/contract management determinations. In each of those cases, the cognizant Administrative Contracting Officer concurred with the auditor and determined the contractor estimating system to be generally adequate. No further actions could be reasonably anticipated on the minor deficiencies reported, because acceptable corrective actions were either in the process of being implemented or were scheduled for validation by the cognizant Defense Contract Audit Agency office. In all three cases, the

Defense Contract Audit Agency concurred with the Administrative Contracting Officer/contract management decisions.

- Three reports were not included in the contract audit follow-up system because the cognizant Administrative Contracting Officers agreed with the audit findings that the contractor corrective actions were generally adequate and acceptable and the remaining observations were either immaterial or had been scheduled for follow-up compliance reviews by the Defense Contract Audit Agency.

The review by the Office of the Inspector General, DoD, found that Administrative Contracting Officers were taking appropriate follow-up actions on the audit report findings and recommendations, even though they had not reported all of them in the DoD contract audit follow-up system. Based on this additional data, the Department concluded that, although a number of audits should have been reported pursuant to the requirements of DoD Directive 7640.2, appropriate follow-up actions are being taken on the open issues, which is the major objective of the contract audit follow-up program.

FINDING C: DoD Audit Follow-up System on Contractor Cost Estimating Systems is Inaccurate and Incomplete--Age of Cost Estimating Deficiencies Understated. The GAO reported that superseding previous reports was the primary reason the audit follow-up system overstated the progress made by 17 contractors in correcting estimating system deficiencies. The GAO explained that the 17 Defense Contract Audit Agency reports showed previously identified deficiencies remained uncorrected for an average of 32 months; however, the audit follow-up system showed that the deficiencies were outstanding for only nine months. The GAO contacted eight of the 17 Administrative Contracting Offices and found that, for seven of the reports, the follow-up reports issued by the Defense Contract Audit Agency were used as the basis for the disposition or closing of the report. The GAO observed that all seven complied with the requirement to supersede the initial report and cited it as the reason for dropping the initial audit report. In the eighth case, the Defense Contract Audit Agency initial report was missing from the system, therefore, the GAO could not determine if the Administrative Contracting Officer had closed the report.

The GAO noted that, according to DoD guidance, disposition of audit findings is achieved when a subsequent report is issued because tracking the initial results of certain types of audits--such as overhead and defective pricing--is not needed when follow-up reports are issued. The GAO concluded, however, for cost estimating system audits, that requirement causes the audit follow-up system to lose the date when the Defense Contract Audit Agency first reported the

Now on pp. 5 and 6.

uncorrected cost estimating deficiencies. The GAO further concluded that such practice can result in erroneous conclusions regarding the timeliness of the contractor corrective actions on the deficiencies. (pp. 7-8/GAO Draft Report)

DOD RESPONSE: Concur. In its December 12, 1991 report, "Review of Actions Taken on 42 Contractor Estimating Systems" (Report No. AFU 92-1), the Office of the Inspector General, DoD, concluded that the DoD contract audit follow-up system should contain the date the Defense Contract Audit Agency initially reported deficiencies in a contractor cost estimating or accounting system, and has taken action to ensure that the audit follow-up system contains such information.

FINDING D: DoD Audit Follow-up System on Contractor Cost Estimating Systems is Inaccurate and Incomplete—Corrective Actions Inaccurately Shown. The GAO concluded that a contractor corrective action plan addressing the Defense Contract Audit Agency audit recommendations, but without implementation of the plan or only partial implementation of a plan addressing the Audit Agency audit recommendations, is not sufficient to support disposition. The GAO found, however, that DoD Administrative Contracting Officers had assigned a disposition classification to five reports, despite the fact the contractors had not implemented or had only partially implemented the Defense Contract Audit Agency recommendations to correct cost estimating deficiencies. (pp. 8-9/GAO Draft Report)

Now on pp. 6 and 7.

DOD RESPONSE: Concur. The Defense Logistics Agency issued a directive emphasizing that Administrative Contracting Officers should hold open audit reports on contractor estimating systems that contain estimating system deficiencies until all deficiencies are corrected, or the report has been superseded by, or incorporated into, a subsequent report.

FINDING E: Recent Actions on the DoD Audit Follow-Up System. The GAO reported that, during its review, a DoD Process Action Team proposed several changes to improve the accuracy and completeness of the data in the audit follow-up system. The GAO explained that the DoD Process Action Team proposed that the Defense Contract Audit Agency electronically transfer the report numbers of issued audit reports to Administrative Contracting Offices at monthly intervals to reduce the number of missing audit reports. The GAO observed that, in addition, the DoD recently took actions (1) to assure that the audit follow-up system contains information on when the Defense Contract Audit Agency initially reported cost-estimating system deficiencies and to add this date to reports in the follow-up system, (2) to include the date of the report that contains the oldest issue still open in the follow-up system, and (3) to annotate the follow-up

Now on p. 7.

system to show the Defense Contract Audit Agency reports that recommend partial or complete disapproval of the contractor cost-estimating system. The GAO concluded that the changes to the audit follow-up system should provide DoD managers with more reliable information on the status of individual audit reports. The GAO further concluded that, in addition to the indicated changes, Administrative Contracting Officers need to better ensure that contractors complete action adopting audit recommendations before the contracting officers disposition audit reports. (pp. 9-10/GAO Draft Report)

DOD RESPONSE: Concur. On July 1, 1990, the Defense Contract Audit Agency commissioned a Process Action Team to evaluate the DoD process for transmitting information on reports requiring follow-up. Members of the Team included the Defense Contract Audit Agency, the Defense Contract Management Command, and the Office of the Inspector General, DoD. One of its recommendations was to transmit the required data using electronic media. The electronic transfer of such data is expected to begin in January 1993. Implementation of the recommendations and refinements to the Defense Contract Audit Agency Management Information System should greatly increase the accuracy of the transmitted data at a substantial reduction in effort, and eliminate the possibility of reportable estimating system audit reports being excluded from the contract audit follow-up system.

* * * * *

RECOMMENDATION

RECOMMENDATION: The GAO recommended that the Secretary of Defense direct the Director, Defense Logistics Agency, to ensure that Administrative Contracting Officers verify that contractors have corrected all deficiencies cited in the Defense Contract Audit Agency audits of cost-estimating systems--~~before~~ reporting disposition of the audit. (p. 10/GAO Draft Report)

Now on p. 7.

DOD RESPONSE: Concur. On March 30, 1992, the Defense Logistics Agency issued a directive emphasizing that Administrative Contracting Officers should hold open audit reports on contractor estimating systems that contain estimating system deficiencies until all deficiencies are corrected, or the report has been superseded by, or incorporated into, a subsequent report.

The following are our comments on DOD's letter dated April 20, 1992.

GAO Comments

1. DOD Directive 7640.2 requires all cost-estimating system reports with findings and recommendations to be entered into the audit follow-up system. Allowing for the one report that DOD states was in the follow-up system but coded incorrectly, DOD failed to meet that requirement for 11 reports on 12 high-risk contractor divisions.

"Flash reports" related to specific pricing proposals cite estimating deficiencies that require corrective action. We believe that flash reports should be reported in the follow-up system until the corrective action necessary to correct the deficiency is completed. Therefore, we included these reports in our assessment.

We believe that all relevant audit reports should be included in the follow-up system. It is fortunate that the deficiencies noted in the missing reports were tracked through two other reports. However, when reports are missing from the tracking system, DOD loses sight of the progress made by contractors to correct estimating system deficiencies. This can result in erroneous conclusions regarding the timeliness of contractor corrective actions.

DOD Directive 7640.2 contains no provision for subjective determinations regarding the significance of cost-estimating system report findings. All such reports are to be included in the system. It is important to note that all the audits discussed in our report relate to the contractors DCAA has designated as high risk for cost-estimating system problems. We believe that it is important to record all reports that cite deficiencies related to these contractors and to ensure that appropriate corrective action is taken and completed in a timely manner.

We agree it is important that DOD administrative contracting officers take appropriate follow-up action on audit report findings and recommendations. However, if those report findings and recommendations are not included in the follow-up system, the system cannot provide the data needed to allow DOD management and the Congress to properly oversee the timely correction of contractor deficiencies. We believe it is important that DOD comply with its regulations and report all relevant audit reports so that DOD can ensure that appropriate follow-up action is taken in a timely manner. We believe this is critical when data from DOD's 7640.2 follow-up system is used (1) to brief the Congress on the status of audit

findings and (2) to assure the Congress that the audit follow-up system already provides DOD management with necessary insight into the prime contractor and subcontractor problems reported by us, the DOD/IG, and DCAA.

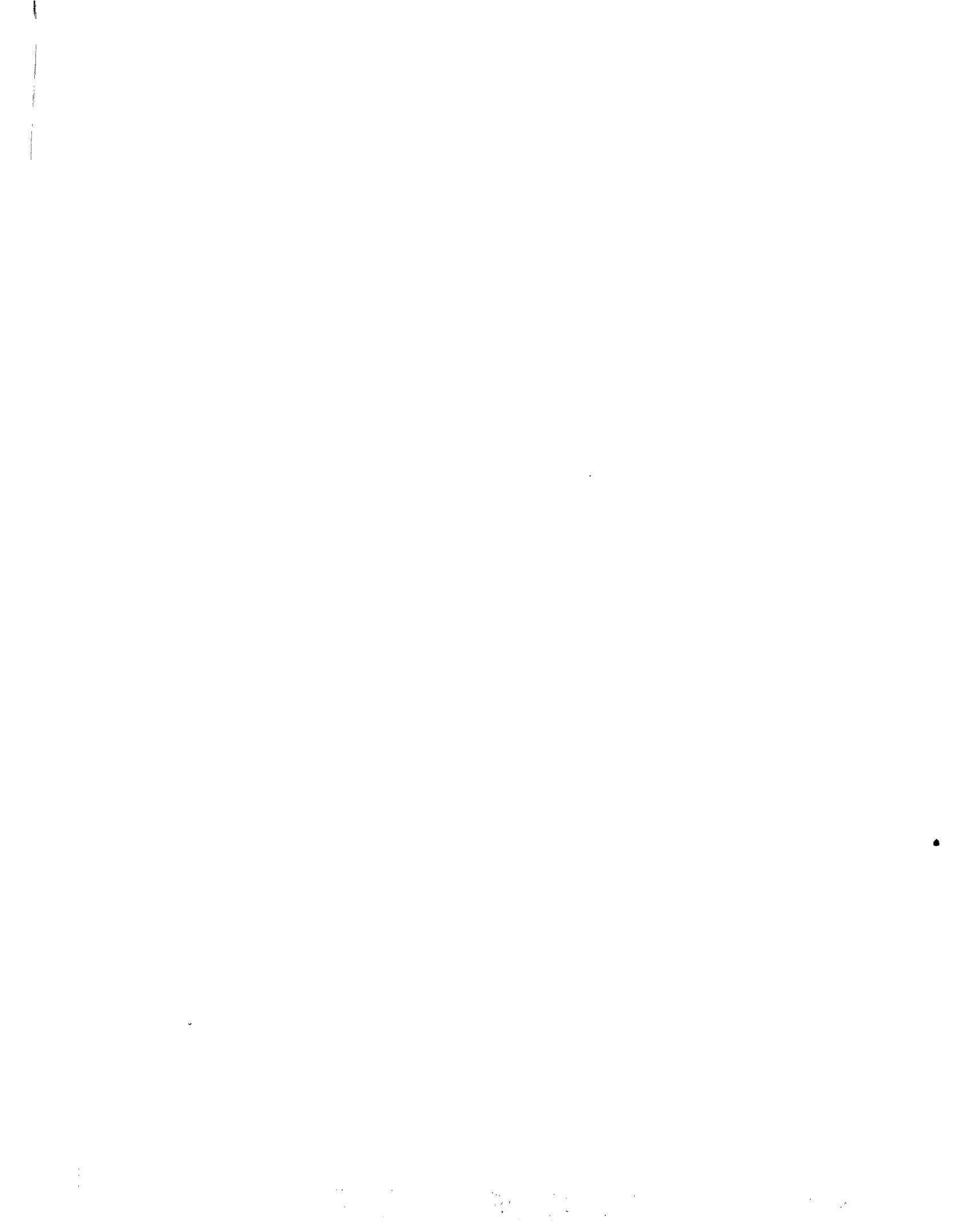
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