

Highlights of [GAO-11-331T](#), a testimony before the Subcommittee on Contracting Oversight, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Agencies across the government are increasingly reliant on contractors to execute their missions. With hundreds of billions of taxpayer dollars at stake, the government needs strong controls to provide reasonable assurance that these contract funds are not being lost to improper payments (fraud and errors), waste, and mismanagement.

Effective contract oversight, which includes effective internal controls throughout the contracting process, is essential to protecting government and taxpayer interests. *Standards for Internal Control in the Federal Government* provides the overall framework for internal control, which includes the control environment, risk assessment, control activities, information and communication, and monitoring.

Contract auditing is a control mechanism intended to provide those responsible for government procurement with financial information and advice relating to contractual matters and the effectiveness, efficiency, and economy of contractors' operations.

Today's testimony describes the (1) contracting cycle and related internal controls, (2) Defense Contract Audit Agency (DCAA) and its role in performing contract audits for the Department of Defense (DOD) and other federal agencies, and (3) risks associated with ineffective contract controls and auditing.

GAO's testimony is based on prior reports and testimonies, as listed at the end of this statement.

View [GAO-11-331T](#) or key components. For more information, contact Jeanette M. Franzel at (202) 512-9471 or franzelj@gao.gov.

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CONTRACT AUDITS

Role in Helping Ensure Effective Oversight and Reducing Improper Payments

What GAO Found

The contracting cycle consists of activities throughout the acquisition process, including preaward and award, contract administration and management, and ultimately the contract closeout. Strong internal controls contain a balance of preventive and detective controls appropriate for the agency's operation and help ensure an effective contract oversight process. Preventive controls—such as invoice review prior to payment—are controls designed to prevent improper payments, waste, and mismanagement, while detective controls—such as incurred cost audits—are designed to identify improper payments after the payment is made. While detective controls identify funds that may have been inappropriately paid and should be returned to the government, preventive controls help to reduce the risk of improper payments or waste before they occur.

DOD accounts for the largest share of federal contract spending. DCAA was established in 1965 in response to studies which identified the need for consistency in contract audits at DOD. DCAA serves a critical role in DOD and other federal agency contractor oversight by providing auditing, accounting, and financial advisory services in connection with the negotiation, administration, and closeout of contracts and subcontracts. The majority of DCAA audits focus on cost-reimbursable and other nonfixed-price contracts, which pose the highest risk to the government.

Reported federal contract obligations—which have increased by \$100 billion in real terms since fiscal year 2005, from \$435 billion to \$535 billion in fiscal year 2010—poses significant risk if effective contract oversight is not in place. GAO's work has identified contract management weaknesses, significant problems with federal agency controls over contract payments, and internal control deficiencies throughout the contracting process, including contract auditing. GAO also found audit quality problems at DCAA offices nationwide, including compromise of auditor independence, insufficient audit testing, and inadequate planning and supervision.

DCAA and the other federal agencies mentioned in GAO's testimony have completed some actions and have actions under way to address GAO's recommendations. GAO made 17 recommendations to DOD and the DOD Inspector General (IG) to address the weaknesses it identified at DCAA. DOD and DCAA have taken a number of actions on these recommendations, including revising DCAA's mission statement, appointing a new DCAA Director and a Western Region Director, establishing an internal review office to perform periodic internal evaluations and address hotline complaints, initiating outside hiring, strengthening its audit quality review function, and providing training on auditing standards. DCAA has actions under way on other recommendations. DOD IG has expanded its oversight of DCAA's audit quality control process. In addition, the Centers for Medicare and Medicaid Services (CMS) have completed actions on two recommendations and expect to complete actions on all but one of the remaining 16 recommendations by March 31, 2011. Department of Energy official's stated that actions have been complete on all 11 GAO recommendations. GAO is following up to confirm.