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CENTERS FOR MEDICARE AND MEDICAID SERVICES

Deficiencies in Contract Management Internal Control Are Pervasive



GAO

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Highlights of [GAO-10-60](#), a report to congressional requesters

Why GAO Did This Study

As a result of internal control deficiencies discussed in GAO's 2007 report on certain contracts at the Centers for Medicare and Medicaid Services (CMS), GAO was asked to identify the extent to which CMS (1) implemented effective control procedures over contract actions, and (2) established a strong control environment for contract management. GAO used a statistical random sample of 2008 CMS contract actions (including contract awards and modifications) to assess CMS internal control procedures. The results were projected to the population of 2008 CMS contract actions. GAO also determined the extent to which CMS implemented recommendations GAO made in 2007 to improve internal control over contracting and payments to contractors. GAO reviewed contract file documentation and interviewed senior acquisition management officials.

What GAO Recommends

GAO makes 10 recommendations for developing policies to improve oversight and strengthen CMS's control environment. It also reaffirms 7 prior recommendations that CMS has not fully implemented. CMS concurred with the new recommendations, but generally disagreed with GAO's assessment of progress on the prior recommendations. GAO's analysis confirmed the need for additional efforts on these recommendations.

[View GAO-10-60 or key components.](#)
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CENTERS FOR MEDICARE AND MEDICAID SERVICES

Deficiencies in Contract Management Internal Control Are Pervasive

What GAO Found

Pervasive deficiencies in CMS contract management internal control increase the risk of improper payments or waste. Specifically, based on our statistical random sample of 2008 CMS contract actions, GAO estimates that at least 84.3 percent of fiscal year 2008 contract actions contained at least one instance where a key control was not adequately implemented. GAO also estimates that at least 37.2 percent of fiscal year 2008 contract actions had three or more instances in which a key control was not adequately implemented. The contract actions GAO evaluated were generally subject to the Federal Acquisition Regulation. For example, CMS used cost reimbursement contracts without first ensuring that the contractor had an adequate accounting system. Also, project officers did not always certify invoices for payment. These deficiencies were due in part to a lack of agency-specific policies and procedures to help ensure proper contracting expenditures.

These control deficiencies also stem from a weak overall control environment as characterized primarily by inadequate strategic planning for staffing and funding resources. CMS also did not accurately capture data on the nature and extent of its contracting, which hinders CMS's ability to manage its acquisition function by identifying areas of risk, due to a lack of quality assurance procedures over data entry. CMS also has not substantially addressed seven of the nine recommendations made by GAO in 2007 to improve internal control over contracting and payments to contractors. For example, CMS has not made progress in clarifying the roles and responsibilities for implementing certain contractor oversight responsibilities and, as of July 2009, CMS still had a backlog of contacts that were overdue for closeout, putting CMS at increased risk of not identifying or recovering improper payments or waste.

GAO Assessment of CMS Actions to Address Prior Recommendations

	GAO recommendation	GAO assessment
1	Develop policies for pre-award contract activities.	No action taken
2	Develop policies regarding cognizant federal agency responsibilities.	Actions insufficient
3	Develop policies that clarify roles and responsibilities during the invoice review process.	Completed
4	Develop guidelines regarding sufficient detail to support contractor invoices.	No action taken
5	Establish criteria for negative certification for payment of invoices.	No action taken
6	Provide training on the invoice review policies.	Actions insufficient
7	Develop a centralized tracking mechanism for employee training.	Completed
8	Develop a plan to reduce the backlog of contracts eligible for closeout.	Actions insufficient
9	Review the questionable payments identified in GAO's 2007 report.	Actions insufficient

Source: GAO.

The continuing weaknesses in contracting activities and limited progress in addressing known deficiencies will continue to put billions of taxpayer dollars at risk of improper payments or waste.

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Abbreviations

ACMIS	Acquisition Career Management Information System
CAS	Cost Accounting Standards
CFA	cognizant federal agency
CMS	Centers for Medicare and Medicaid Services
CRB	Contract Review Board
DCAA	Defense Contract Audit Agency
DCIS	Departmental Contracts Information System
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System Next Generation
FTE	full time equivalents
HHS	Department of Health and Human Services
HHSAR	Health and Human Services Acquisition Regulations
MMA	Medicare Prescription Drug, Improvement, and Modernization Act of 2003
NIH	National Institutes of Health
T&M	time and materials
OAGM	Office of Acquisition and Grants Management
OFM	Office of Financial Management
OIG	Office of the Inspector General
OMB	Office of Management and Budget
SBA	Small Business Administration
V&V	Verification and Validation

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United States Government Accountability Office
Washington, DC 20548

October 23, 2009

Congressional Requesters

The Centers for Medicare and Medicaid Services (CMS), a component of the Department of Health and Human Services (HHS), administers the high-risk programs of Medicare and Medicaid,¹ and other programs such as the State Children's Health Insurance Program. CMS relies extensively on contractors to assist in carrying out its basic mission, including program administration, management, and oversight of its health programs. In fiscal year 2008, CMS reported that it obligated \$3.6 billion under contracts for a variety of goods and services. CMS's acquisitions include contracts to administer, oversee, and audit claims made under the Medicare program; provide information technology systems; provide program management and consulting services; and operate the 1-800 Medicare help line.

In November 2007, we reported² significant deficiencies in internal control over certain contracts used by CMS for start-up administrative services to implement programs enacted under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA).³ Internal control—the plans, methods, and procedures used to meet missions, goals, and objectives—is the first line of defense in safeguarding assets and preventing and detecting fraud and errors and helps government program managers achieve desired results through effective stewardship of public resources. We reported that CMS's internal control deficiencies resulted in millions of dollars of questionable payments to contractors, primarily because CMS did not obtain adequate support for billed costs from certain contractors.

Because of concerns about the implications that these weaknesses may have on all CMS contracts generally subject to the requirements of the Federal Acquisition Regulation (FAR),⁴ you asked us to perform a

¹ GAO, *High Risk Series: An Update*, [GAO-09-271](#) (Washington, D.C.: Jan. 22, 2009).

² GAO, *Centers for Medicare and Medicaid Services: Internal Control Deficiencies Resulted in Millions of Dollars of Questionable Contract Payments*, [GAO-08-54](#) (Washington, D.C.: Nov. 15, 2007).

³ Pub. L. No. 108-173, 117 Stat. 2066 (Dec. 8, 2003).

⁴ 48 C.F.R. ch. 1.

comprehensive, in-depth review of CMS's contract management practices. This report addresses the extent to which (1) CMS implemented effective internal control procedures over contract actions to help ensure proper contracting expenditures and (2) CMS established a strong control environment for contract management.

To address the extent to which CMS implemented control procedures over contract actions, we focused on contracts that were generally subject to the FAR (i.e., FAR-based),⁵ which represented about \$2.5 billion, or about 70 percent, of total obligations awarded in fiscal year 2008. The FAR is the governmentwide regulation containing the rules, standards, and requirements for the award, administration, and termination of government contracts. Based on the standards for internal control,⁶ FAR requirements, and agency policies, we identified and evaluated 11 key internal control procedures over contract actions, ranging from ensuring contractors had adequate accounting systems prior to the use of a cost reimbursement contract to certifying invoices for payment. Contract actions include new contract awards and modifications to existing contracts. We conducted our tests on a statistically random sample⁷ of 102 FAR-based contract actions CMS made in fiscal year 2008 and projected the results of our statistical sample conservatively by reporting the lower bound of our two-sided, 95 percent confidence interval. We tested a variety of contract actions including a range of dollars obligated, different contract types (fixed price, cost reimbursement, etc.), and the types of goods and services procured. The actions in the sample ranged from a \$1,000 firm-fixed price contract for newspapers to a \$17.5 million modification of an information technology contract valued at over \$500 million. For each contract action in the sample, we determined if the 11 key internal control procedures were implemented by reviewing the contract file supporting the action and, where applicable, by obtaining additional information from the contracting officer or specialist or senior

⁵ Certain CMS contracts, such as the claims administration contracts referred to as fiscal intermediaries and carriers, generally are not subject to FAR requirements. CMS is transitioning these contracts to FAR-based acquisitions in response to requirements in the MMA. This transition, referred to as Medicare contracting reform, should be completed by 2011.

⁶ GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

⁷ We selected a stratified random sample of 102 contract actions from a population of 2,441 total contract actions recorded in CMS's procurement system, PRISM, during fiscal year 2008. See app. I for additional sample details.

acquisition management. We also tested the reliability of the data contained in CMS's two acquisition databases. Basic attributes of its contract actions, such as contractor name and obligation amount, which we found to be reliable for purposes of this report, were used to produce the historical obligation information presented in the background section.⁸

To address the extent to which CMS established a strong control environment for contract management, we obtained and reviewed documentation regarding contract closeout, acquisition planning, and other management information and interviewed officials in the Office of Acquisition and Grants Management (OAGM) about its contract management processes. We also evaluated whether CMS had addressed recommendations we made in our prior report.⁹ We used the internal control standards as a basis for our evaluation of CMS's contract management control environment.

Appendix I provides additional details of our scope and methodology. We conducted this performance audit from July 2008 to September 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Nature and Extent of CMS Contracting

CMS reported total obligations for CMS contracts in fiscal year 2008 were \$3.6 billion. This amount includes obligations against contracts that process Medicare claims as well as obligations to other contractors such as those that operate the 1-800 Medicare help line, provide program management and consulting services, and support information technology.

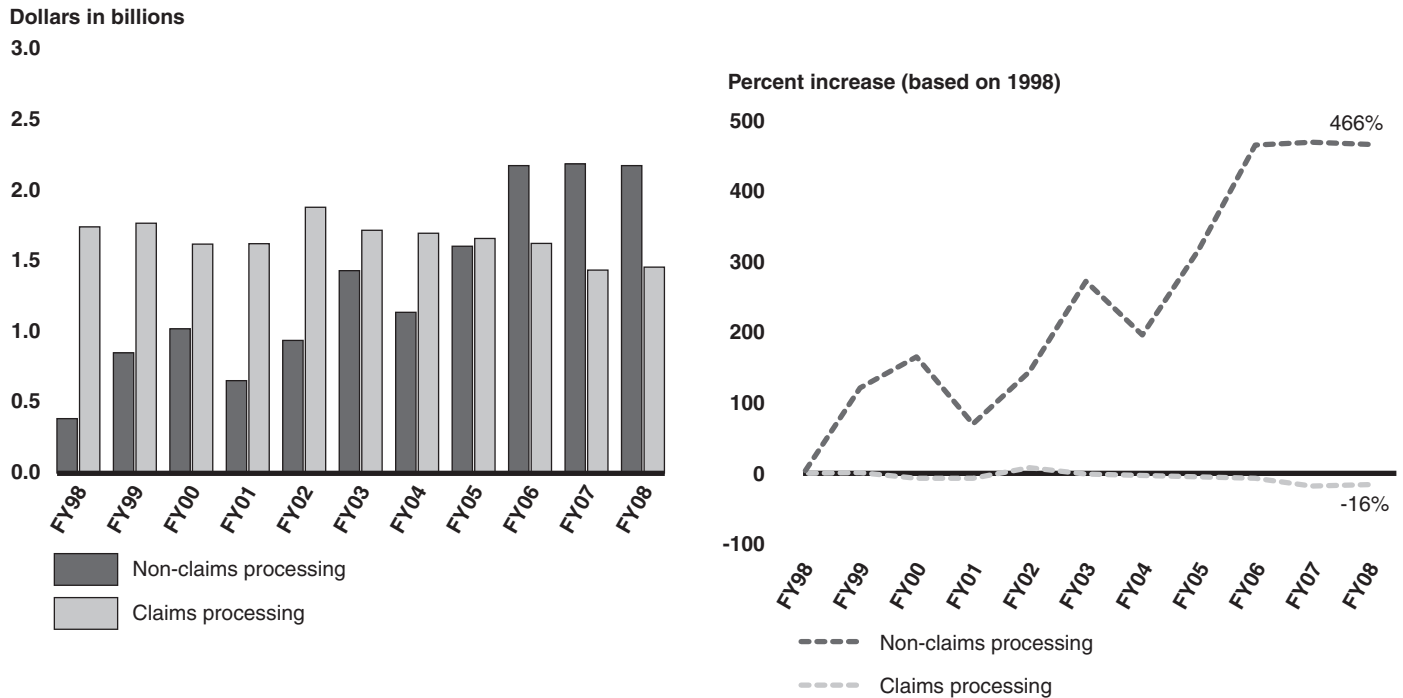
⁸ An obligation is a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Payment may be made immediately or in the future.

⁹ [GAO-08-54](#).

The \$3.6 billion obligated in 2008 represents a 71 percent increase since 1998, when \$2.1 billion was obligated.

Since 1998, obligations to fiscal intermediaries, carriers, and Medicare Administrative Contractors (contractors that primarily process Medicare claims) have decreased approximately 16 percent. Obligations for other-than-claims processing activities, such as the 1-800 help line, information technology and financial management initiatives, and program management and consulting services, have increased 466 percent, as shown in figure 1. These trends may be explained in part by recent changes to the Medicare program, including the movement of functions, such as the help line, data centers, and certain financial management activities, from the fiscal intermediaries and carriers to specialized contractors. These specialized contractors, such as beneficiary contact center contractors and enterprise data center contractors, are categorized below as other-than-claims processing contractors.

Figure 1: CMS Contracting Trends between 1998 and 2008



Source: GAO analysis of CMS-provided obligation data from the PRISM database.

MMA required CMS to transition its Medicare claims processing contracts, which generally did not follow the FAR, to the FAR environment through the award of contracts to Medicare Administrative Contractors. CMS projected that the transition, referred to as Medicare contracting reform, would produce administrative cost savings due to the effects of competition and contract consolidation as well as produce Medicare trust fund savings due to a reduction in the amount of improper benefit payments. Additionally, the transition would subject millions of dollars of CMS acquisitions to the rules, standards, and requirements for the award, administration, and termination of government contracts in the FAR. Obligations to the new Medicare Administrative Contractors were first made in fiscal year 2007. CMS is required to complete Medicare contracting reform by 2011. As of September 1, 2009, 19 contracts have been awarded¹⁰ to Medicare Administrative Contractors, totaling about \$1 billion in obligations to date.

Except for certain Medicare claims processing contracts,¹¹ CMS contracts are generally required to be awarded and administered in accordance with general government procurement laws¹² and regulations such as the FAR; the Health and Human Services Acquisition Regulations (HHSAR);¹³ the Cost Accounting Standards (CAS);¹⁴ and the terms of the contract.

Overview of CMS Contract Management

At CMS, OAGM manages contracting activities and is responsible for, among other things, (1) developing policy and procedures for use by acquisition staff; (2) coordinating and conducting acquisition training; and

¹⁰ Of the 19 contracts awarded, 6 are under protest and are not yet operational.

¹¹ CMS contracts with fiscal intermediaries and carriers for Medicare claims processing generally do not follow the FAR.

¹² Title 41, United States Code.

¹³ 48 C.F.R. ch. 3.

¹⁴ 48 C.F.R. ch. 99. These standards are mandatory for use by all executive agencies and by contractors and subcontractors in estimating, accumulating, and reporting costs in connection with pricing and administration of, and settlement of disputes concerning, all negotiated prime contract and subcontract procurements with the U.S. government in excess of \$500,000. Certain contracts or subcontracts are exempt from CAS, such as those that are fixed price or those with a small business. Additionally, contractors that received less than \$50 million in net awards in the prior accounting period are subject to only certain CAS standards, known as modified coverage. The FAR incorporates the CAS, see 48 C.F.R. §30.101(b).

(3) negotiation, award, administration, and termination of contracts. Multiple key players work together to monitor different aspects of contractor performance and execute pre-award and post-award contract oversight. All but one of the key roles described below are managed centrally in OAGM. The last, project officers, are assigned from CMS program offices.

- Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, overseeing contractor compliance with the terms of the contract, and safeguarding the interests of the government in its contractual relationships. The contracting officer is authorized to enter into, modify, and terminate contracts. According to OAGM's invoice review policy, contracting officers, with the assistance of the contract specialists, review contractor invoices for compliance with contract terms, among other things.
- Contract specialists represent and assist the contracting officers with the contract, but are generally not authorized to commit or bind the government. The contract specialist assists with the invoice review process.
- The cost/price team serves as an in-house consultant to others involved in the contracting process at CMS. By request, the team, which consists of four contract auditors, provides support for contract administration including reviewing cost proposals, consultations about the allowability of costs billed on invoices, and assistance during contract closeout.
- Project officers serve as the contracting officer's technical representative designated to monitor the contractor's progress, including the surveillance and assessment of performance and compliance with project objectives. According to OAGM invoice review policy, project officers review certain invoice elements, such as labor and direct costs, and are required to certify whether the invoice is approved for payment by signing a Payments and Progress Certification Form. They may also conduct periodic analyses of contractor performance and cost data.

CMS utilizes two different databases of acquisition information for a variety of internal and external reporting on its acquisition activities. The PRISM database contains basic information such as contract number, vendor name, and amount obligated. PRISM is used to develop contract

documents and for internal reporting and acquisition planning. The Enhanced Departmental Contracts Information System (DCIS) is an HHS database that is used for department-level acquisition management and to satisfy external reporting requirements. DCIS collects and forwards information to the Federal Procurement Data System Next Generation (FPDS-NG), which is a publicly available database of governmentwide acquisition information. Likewise, FPDS-NG feeds into www.usaspending.gov, a Web site created in response to the Federal Funding Accountability and Transparency Act of 2006,¹⁵ which required a single searchable Web site, accessible by the public for free, that reports key information for each federal award.

Federal Acquisition, Contract Types, and Cognizant Federal Agency Responsibilities

The contract life cycle includes many acquisition and administrative activities. Prior to award, an agency identifies a need; develops a requirements package; determines the method of contracting; solicits and evaluates bids or proposals; and ultimately awards a contract. After contract award, the agency performs contract administration and contract closeout. Contract administration involves monitoring the contractor's performance as well as reviewing and approving (or disapproving) the contractor's request for payment. Other tasks may include audits or reviews of the contractor's costs and compliance with CAS. The contract closeout process involves verifying that the goods or services were provided and that administrative matters are completed, including a contract audit of costs billed to the government and adjusting for any over- or underpayments based on the final invoice.

Agencies may choose among different contract types to acquire goods and services. This choice is the principal means that agencies have for allocating risk between the government and the contractor. Contract types can be grouped into three broad categories: fixed price contracts, cost reimbursement contracts, and time and materials (T&M) contracts. Although the FAR places limitations on the use of cost reimbursement and T&M contract types, these contract types may be used to provide the flexibility needed by the government to acquire the large variety and volume of supplies and services it needs. As discussed below, these three types of contracts place different levels of risk on the government and the contractor. Generally, the government manages its risk, in part, through oversight activities.

¹⁵ Pub. L. No. 109-282, 120 Stat. 1186 (Sept. 26, 2006).

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- For fixed price contracts, the government agrees to pay a set price for goods or services regardless of the actual cost to the contractor. A fixed price contract is ordinarily in the government's interest when the risk involved is minimal or can be predicted with an acceptable degree of certainty and a sound basis for pricing exists, as the contractor assumes the risk for cost overruns.
 - Under cost reimbursement contracts, the government agrees to pay those costs of the contractor that are allowable, reasonable, and allocable to the extent prescribed by the contract. The government assumes most of the cost risk because the contractor is only required to provide its best effort to meet contract objectives within the estimated cost. If this cannot be done, the government can provide additional funds to complete the effort, decide not to provide additional funds, or terminate the contract. Cost reimbursement contracts may be used only when the contractor's accounting system is adequate for determining costs applicable to the contract and appropriate government surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used.¹⁶ In order to determine if the contractor has efficient methods and effective cost controls, contracting officers and other contracting oversight personnel may perform a comprehensive review of contractor invoices to determine if the contractor is billing costs in accordance with the contract terms and applicable government regulations. In addition, the establishment of provisional and final indirect cost rates helps to ensure that the government makes payments for costs that are allowable, reasonable, and allocable to the extent prescribed by the contract.
 - For T&M contracts, the government agrees to pay fixed per-hour labor rates and to reimburse other costs directly related to the contract, such as materials, equipment, or travel, based on cost. Like cost reimbursement contracts, the government assumes the cost risk because the contractor is only required to make a good faith effort to meet the government's needs within a ceiling price. A T&M contract may be used only if the contracting officer prepares a determination and findings that no other contract type is suitable and if the contract includes a ceiling price that the contractor exceeds at its own risk.¹⁷ In addition, since these contracts provide no positive profit incentive for

¹⁶ 48 C.F.R. §§ 16.104(h), 16.301-3(a).

¹⁷ 48 C.F.R. § 16.601(d).

the contractor to control costs or use labor efficiently, the government must conduct appropriate surveillance of contractor performance to ensure efficient methods and effective cost controls are being used.

The FAR defines cognizant federal agency (CFA) as the agency responsible for establishing forward pricing rates,¹⁸ final indirect cost rates (when not accomplished by a designated contract auditor), and administering cost accounting standards for all contracts in a business unit.¹⁹ Generally, the CFA is the agency with the largest dollar amount of negotiated contracts, including options, with the contractor. In addition, the CFA may be responsible for establishing provisional indirect cost rates (also known as “billing rates”)²⁰ based on recent reviews, previous rate audits, experience, or similar reliable data to ensure that estimates are as close as possible to final indirect cost rates anticipated.

Internal Control

The *Standards for Internal Control in the Federal Government* provide the overall framework for establishing and maintaining internal control and for identifying and addressing areas at greatest risk of fraud, waste, abuse, and mismanagement. These standards provide that—to be effective—an entity’s management should establish both a supportive overall control environment and specific control activities directed at carrying out its objectives. As such, an entity’s management should establish and maintain an environment that sets a positive and supportive attitude towards control and conscientious management. A positive control environment provides discipline and structure as well as a climate supportive of quality internal control, and includes an assessment of the risks the agency faces from both external and internal sources. Control activities are the policies, procedures, techniques, and mechanisms that enforce management’s directives and help ensure that actions are taken to address risks. The standards further provide that information should be recorded and communicated to management and oversight officials in a form and within a time frame that enables them to carry out their responsibilities. Finally, an entity should have internal control monitoring

¹⁸ Forward pricing rates represent an agreement negotiated between a contractor and the government to make certain rates available during a specified period for use in pricing contracts or modifications.

¹⁹ 48 C.F.R. §§ 2.101. See 48 C.F.R. §§ 42.302(a), 42.703-1, 30.601.

²⁰ 48 C.F.R. § 42.704(a) and (b).

activities in place to assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Control activities include both preventive and detective controls. Preventive controls—such as invoice review prior to payment—are controls designed to prevent errors, improper payments, or waste, while detective controls—such as incurred cost audits—are designed to identify errors or improper payments after the payment is made. A sound system of internal control contains a balance of both preventive and detective controls that is appropriate for the agency’s operations. While detective controls are beneficial in that they identify funds that may have been inappropriately paid and should be returned to the government, preventive controls such as accounting system reviews and invoice reviews help to reduce the risk of improper payments or waste before they occur. A key concept introduced in our standards is that control activities selected for implementation be cost beneficial. Generally it is more effective and efficient to prevent improper payments. A control activity can be preventive, detective, or both based on when the control occurs in the contract life cycle.

Pervasive Deficiencies in Control Procedures at the Contract Level Increase the Risk of Improper Payments or Waste

We found pervasive deficiencies in internal control over contracting and payments to contractors. The internal control deficiencies occurred throughout the contracting process, that is both pre- and post-award, and increase the risk of improper payments or waste. These deficiencies were due in part to a lack of agency-specific policies and procedures to ensure that FAR requirements and other control objectives were met. CMS also did not take appropriate steps to ensure that existing policies were properly implemented nor maintain adequate documentation in its contract files. Further, the Contract Review Board was not effective in ensuring proper contract award actions. These internal control deficiencies are a manifestation of CMS’s weak overall control environment, which is discussed later.

As a result of our work, we estimate that at least 84.3 percent²¹ of FAR-based contract actions made by CMS in fiscal year 2008 contained at least one instance in which a key control was not adequately implemented. (See table 3 in app. I for a list of the 11 controls we tested, which ranged from

²¹ Based on the results of our work, we are 95 percent confident that the percentage of contract actions that did not meet at least one control test is at least 84.3 percent.

ensuring contractors had adequate accounting systems prior to the use of a cost reimbursement contract to certifying invoices for payment.) Not only was the number of internal control deficiencies widespread, but also many contract actions had more than one deficiency. We also estimate that at least 37.2 percent²² of FAR-based contract actions made in fiscal year 2008 had three or more instances in which a key control was not adequately implemented. The high percentage of deficiencies indicates a serious failure of control procedures over FAR-based acquisitions, thereby creating a heightened risk of making improper payments or waste. We determined a control to be “key” based on our review of the standards for internal control as well as the FAR, HHSAR, and agency policies and whether inadequate implementation would significantly increase the risk of improper payments or waste. We also took into consideration prior audit findings and the contract types CMS most frequently used. See appendix I for additional details on the controls we tested and the statistical sample results. We project the results of our statistical sample conservatively by reporting the lower bound of our two-sided, 95 percent confidence interval.

CMS’s Lack of Policies and Procedures Resulted in Numerous Control Deficiencies

The control deficiencies we found were primarily caused by a lack of agency-specific policies and procedures that would help ensure that applicable FAR requirements, agency policies, and other control objectives were met. CMS did not always meet FAR requirements for specific contract types that were awarded, nor maintain adequate support for approved provisional indirect cost rates, which are necessary to determine the reasonableness of indirect costs billed on invoices. Additionally, CMS did not timely perform or request audits of incurred direct and indirect costs, which provide assurance that costs billed by the contractor are allowable and reasonable under the terms of the contract and applicable government regulations. These control deficiencies are discussed in detail below and the results of the other control procedures we tested can be found in appendix I.

- **We estimate that at least 46.0 percent of fiscal year 2008 CMS contract actions did not meet the FAR requirements applicable**

²² Based on the results of our work, we are 95 percent confident that the percentage of contract actions that did not meet three or more control tests is at least 37.2 percent.

to the specific contract type awarded.²³ Sixteen contract actions we tested had deficiencies—of which 1 related to a letter contract,²⁴ 9 related to cost reimbursement contracts, and 6 related to T&M contracts. In the case of the letter contract, the contract file did not contain the authorization for use of the letter contract, which is required by HHSAR.²⁵ In the case of cost reimbursement contracts, the FAR states that a cost reimbursement contract may be used only when the contractor's accounting system is adequate for determining costs applicable to the contract.²⁶ Of the contract awards in our sample, we found 9 cases in which cost reimbursement contracts were used without first ensuring that the contractor had an adequate accounting system. An adequate contractor accounting system is key to the government's ability to perform the various contract oversight activities required by the FAR for cost reimbursement contracts. In particular, contracting officers and other members of the federal agency acquisition workforce rely on the contractors' contract proposals, interim billings, provisional indirect cost rates, and reports of actual costs incurred (which are used to finalize the direct and indirect costs billed) all of which are generated from data maintained in the contractor's accounting system. In addition to the 9 cases above, during our review of modifications we observed another 6 cases in which cost reimbursement contracts were used even though CMS was aware that the contractor's accounting system was inadequate at the time of award. In one instance, the contracting officer was aware that a contractor had an inadequate accounting system resulting from numerous instances of noncompliance with CAS. Using a cost reimbursement contract when a contractor does not have an adequate accounting system hinders the government's ability to fulfill its oversight duties throughout the contract life cycle. Additionally, it increases risk of improper payments and the risk that costs billed can not be substantiated during an audit.

²³ We identified 25 contract actions to which FAR requirements specific to the contract type awarded applied, of which 16 contract actions did not meet the control test. Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 46.0 percent.

²⁴ A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services.

²⁵ 48 C.F.R. § 316.603-3.

²⁶ 48 C.F.R. §§ 16.104(h), 16.301-3. The lack of evidence of an adequate accounting system on a cost reimbursement contract may also indicate that a prospective contractor is not responsible. See 48 C.F.R. § 9.104-1(e) and B-239114, Matter of: Henry G. Kirschenmann, Jr., July 23, 1990.

When choosing to use T&M contracts, the FAR requires contracting officers to prepare and sign a determination and finding that no other contract type is suitable for the acquisition.²⁷ The justification is required to set forth enough facts and circumstances to clearly and convincingly justify the specific determination made.²⁸ We found that the determination and finding was either not documented or insufficient in six T&M contract awards we reviewed. In cases when the justification memorandum was prepared, contracting officers merely quoted language from the FAR but did not set forth clear and convincing findings—that is, the particular circumstances, facts, or reasoning essential to support the determination—for why other contract types could not be used. When the contracting officer does not clearly and convincingly document the findings that support using a T&M contract type, OAGM does not have assurance that the appropriate contract type was used. In addition, for three of the contract actions, the contract specialist told us that the actions the document listed to mitigate the risk of awarding a T&M contract were not performed. Because CMS did not carry out the stated mitigation strategies used to justify the selection of the T&M contract type, it increased its exposure to the risk of improper payments or waste.

- **We estimate that for at least 40.4 percent of fiscal year 2008 contract actions, CMS did not have sufficient support for provisional indirect cost rates nor did it identify instances when a contractor billed rates higher than the rates that were approved for use.**²⁹ Specifically, for 17 contract actions that utilized indirect cost rates, CMS did not have documentation supporting what would be the appropriate provisional indirect cost rates for the contractor. For an additional 19 contract actions, the provisional rates either did not match the indirect rates billed on the invoices or could not be matched because the invoice did not provide sufficient detail.³⁰ The FAR states that provisional indirect cost rates shall be used in

²⁷ 48 C.F.R. § 16.601(d).

²⁸ 48 C.F.R. § 1.704.

²⁹ We identified 62 contract actions to which provisional indirect cost rates applied, of which 36 contract actions did not meet the control test. Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 40.4 percent.

³⁰ In some cases, the contractor billed indirect costs following a different structure or the contractor did not provide sufficient detail on the invoice (such as the rate and base to which the rate is applied) to allow a match to the approved provisional indirect cost rates.

reimbursing indirect costs such as fringe benefits or overhead costs under cost reimbursement contracts³¹ and are used to prevent substantial overpayment or underpayment of indirect costs.³² These rates are generally established by the CFA, contracting officer, or auditor on the basis of reliable data or previous rate audits and should be set as close as possible to the anticipated final indirect cost rates.³³ Provisional indirect cost rates provide agencies with a mechanism by which to determine if the indirect costs billed on invoices are reasonable for the services provided until such time that final indirect cost rates can be established, generally at the end of the contractor's fiscal year. Approval of provisional indirect cost rates is important given the fact that indirect costs can be more than 50 percent of the total invoice amount. When the agency does not maintain adequate support for provisional indirect rates, it increases its risk of making improper payments.

- **We estimate that for at least 52.6 percent of fiscal year 2008 contract actions, CMS did not have support for final indirect cost rates.**³⁴ Specifically, 23 contract actions we tested did not have documentation of final indirect cost rates or support for the prompt request of an audit of indirect costs.³⁵ The FAR states that final indirect cost rates, which are based on the actual indirect costs incurred during a given fiscal year, shall be used in reimbursing

³¹ 48 C.F.R. § 42.703-1(b). Provisional indirect cost rates, sometimes called a materials handling rate, may also be used on some T&M contracts. 48 C.F.R. §§ 16.307(a)(1), 52.216-7.

³² 48 C.F.R. § 52.216-7(e)(2).

³³ 48 C.F.R. § 42.704(b).

³⁴ We identified 34 contract actions to which final indirect cost rates applied, of which 23 contract actions did not meet the control test. Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 52.6 percent.

³⁵ 48 C.F.R. § 52.216-7(d)(2)(i) and (ii) requires that contractors submit a report of their incurred costs (both direct and indirect) to the government no later than 6 months after the end of their fiscal year. The FAR states that the government should establish final indirect cost rates as "promptly as practical" after the receipt of the contractor's report of incurred costs. For purposes of this report, we defined "promptly" as an audit or request for an audit within 12 months of the due date of the incurred cost report, or a total of 18 months from the end of the contractor's fiscal year. In our view, 12 months from the due date of the incurred cost report allows sufficient time for the agency to determine the financial resources necessary to perform the audit or pay another agency, such as the Defense Contract Audit Agency (DCAA), to perform the audit.

indirect costs under cost reimbursement contracts.³⁶ The amounts a contractor billed using provisional indirect cost rates are adjusted annually for final indirect cost rates providing a mechanism for the government to timely ensure that indirect costs are allowable and allocable to the contract. Final indirect cost rates are generally negotiated by the government's negotiating team that includes the CFA following an audit of a statement of incurred costs submitted by the contractor.³⁷ CMS officials told us that they generally adjust for final indirect cost rates during contract closeout at the end of the contract performance rather than annually mainly due to the cost and effort the adjustment takes. Moreover, since final indirect cost rates are established by the CFA, when CMS is not the CFA, CMS must wait on the CFA to perform the necessary audit work required to establish the final indirect cost rates. Not annually adjusting for final indirect cost rates increases the risk that CMS is paying for costs that are not allowable or allocable to the contract. Furthermore, putting off the control activity until the end of contract performance increases the risk of overpaying for indirect costs during contract performance and may make identification or recovery of any unallowable costs during contract closeout more difficult due to the passage of time.

- **We estimate that for at least 54.9 percent of fiscal year 2008 contract actions, CMS did not promptly perform or request an audit of direct costs.**³⁸ We found that 25 contract actions for which this control applied did not have an audit of direct costs promptly³⁹ performed or requested. Similar to the audit of indirect costs, audits of direct costs allow the government to verify that the costs billed by the contractor were allowable, reasonable, and allocable to the contract. The audit of direct costs is the responsibility of the

³⁶ 48 C.F.R. § 42.703-1(b).

³⁷ 48 C.F.R. § 42.705-1(a) and (b)(1).

³⁸ We identified 36 contract actions to which an audit of direct costs applied, of which 25 contract actions did not meet the control test. Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 54.9 percent.

³⁹ For purposes of this report, we defined "promptly" as an audit or request for an audit within 12 months of the due date of the incurred cost report, or a total of 18 months from the end of the contractor's fiscal year. In our view, 12 months from the due date of the incurred cost report allows sufficient time for the agency to determine the financial resources necessary to perform the audit or pay another agency, such as DCAA, to perform the audit.

contracting officer; however, the contracting officer may request, for a fee, that the CFA for the contractor perform the audit work. The FAR does not provide time frames or other requirements for when the audit of direct costs should be performed except that such an audit may be necessary for closing out the contract at the end of contract performance.⁴⁰ Not annually auditing direct costs increases the risk that CMS is paying for costs that are not allowable or allocable to the contract.

CMS Did Not Follow Existing Policies on Invoice Certification and Purchase Card Oversight

CMS had policies for invoice certification and purchase card oversight; however, these policies were not consistently followed. The failure to follow established agency policy increases CMS's risk of improperly paying contractor invoices or purchase card transactions.

- **We estimate that for at least 59.0 percent of fiscal year 2008 contract actions, the project officer did not always certify the invoices.**⁴¹ CMS's Acquisition Policy Notice 16-01 requires the project officer to review each contractor invoice and recommend payment approval or disapproval to the contracting officer. This review is to determine, among other things, if the expenditure rate is commensurate with technical progress and whether all direct cost elements are appropriate, including subcontracts, travel, and equipment. Based on his or her review, the project officer is then to approve the invoice for payment by signing a Payments and Progress Certification Form or disapprove by issuing a suspension notice. In one case, although a contractor submitted over 100 invoices for fiscal year 2008,⁴² only 8 were certified by the project officer. The total value of the contract through January 2009 was about \$64 million.

After the project officer's review, the contracting officer or specialist is also required to review invoices for critical elements such as compliance with the terms of the contract—including indirect cost rates—and mathematical accuracy. Based on a cursory review of the

⁴⁰ 48 C.F.R. § 4.804-5(a)(7) and (12).

⁴¹ We identified 90 contract actions to which certification of invoices applied, of which 61 contract actions did not meet the control test. Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 59.0 percent.

⁴² The contractor submitted separate invoices for different contract line items, which resulted in the high number of invoices in one fiscal year.

fiscal year 2008 invoices submitted for payment, we found instances in which the contracting officer or specialist did not identify items that were inconsistent with the terms of the contract. For example, facilities capital cost of money is generally disallowed by HHSAR.⁴³ However, we found two instances where the contractor billed, and CMS paid, this cost. Another contractor submitted invoices under its fixed price contract that were contrary to the payment schedule stipulated in the contract terms. The contract required the contractor to submit four invoices of equal amount every 3 months during the 1-year performance period. However, the contractor submitted one invoice for the entire amount of the contract. Moreover, the invoice was dated prior to the start date of the contract period of performance. CMS increases its risk of making improper payments when it does not properly review and approve invoices prior to payment.

- **OAGM also did not perform required audits and reviews of CMS purchase cards to identify fraud or waste.**⁴⁴ These audits and reviews are particularly important because of the authorized spending limits. As of July 15, 2009, OAGM's purchase card program had issued 123 cards with 20 percent having monthly spending limits of at least \$50,000. Eight card holders had monthly spending limits of \$100,000, the highest spending limit authorized by CMS. Without sufficient oversight of the purchase card program, CMS does not have assurance that only allowable transactions are procured through purchase cards and that the purchase cards are not being used to circumvent FAR competition requirements.

The HHS purchase card policy guidance provides that the purchase card coordinator, which at CMS is within OAGM, is required to conduct surveillance of the purchase card program by annually auditing cardholder transactions using such methods as statistical and nonstatistical sampling, data mining, and spot checks; monitoring

⁴³ 48 C.F.R. § 315.404-4(d)(4). The HHSAR generally disallows facilities capital cost of money. In cases when the contractor includes the cost in its proposal, the agency is required to reduce the amount of the profit objective by an equivalent amount. In the two instances where CMS paid facilities capital cost of money, the cost was either expressly disallowed by 48 C.F.R. § 52.215-17 or the profit objective was not reduced.

⁴⁴ The government purchase card program offers substantial benefits, but not without risk of fraud, waste, or misuse. 48 C.F.R. § 13.201(b) states that the governmentwide purchase card is the preferred method for making purchases below the micropurchase threshold, which currently is set by FAR at \$3,000 for most types of purchases.

purchase card usage; and deactivating purchase cards when appropriate, among other things. The OAGM purchase card coordinator's supervisor told us that OAGM did not perform the oversight activities because the supervisor viewed those activities as the responsibility of the Office of Financial Management (OFM). We spoke with an OFM official who stated that OFM does not review purchase card transactions for fraud or inappropriate use, but instead pays the purchase card invoice based on the authorizing official's approval.

CMS Did Not Maintain Adequate Documentation in Its Contract Files

During the tests of control procedures, we observed that the contract files did not always contain all required documentation to support the contract actions we reviewed. Standards for internal control call for transactions and other significant events to be clearly documented, and the documentation should be readily available for examination. In addition, the FAR provides that the documentation in the contract files shall be sufficient to constitute a complete history of the contract action for the purpose of providing a basis for informed decisions at each step in the acquisition process, and providing information for reviews and investigations, among other things.⁴⁵ Clearly documenting the history of a contract action is an important tool that provides management with assurance that the agency has complied with applicable regulations and has made well-informed decisions for efficient contract management. Incomplete or inadequate contract files and documentation hinder the ability of the contracting officers to perform their oversight duties, especially those who assume responsibility for contracts that have changed hands during the life of the contract.

CMS contract files did not always contain documentation necessary to support the action and that would provide contracting officers with the tools they needed to adequately perform their oversight functions. Specifically, we found a contract file was missing a statement of work and another file was missing a copy of the actual contract. In addition, two contract files did not maintain any information regarding the General Services Administration schedule contract that was valid at the time of the award of the task order. In numerous instances, we determined that the letter delegating duties to the project officer and the training certificate for the project officer—both of which are required by OAGM policies—were not in the file. Also, a chronological list of contracting officers and their

⁴⁵ 48 C.F.R. § 4.801(b).

dates of responsibility, which provides an important tool for establishing accountability for contract files over time, was consistently absent.

Additionally, we found that CMS's use of negotiation memorandums was inconsistent. The HHSAR provides⁴⁶ that the negotiation memorandum is a complete record of all actions leading to the award of a contract and should be in sufficient detail to explain and support the rationale, judgments, and authorities upon which all actions were predicated and should be signed by the contract negotiator. However, we found that negotiation memorandums were not always prepared for actions in which they were clearly required, and were prepared for actions in which they may not be required, according to HHSAR. Moreover, while many negotiation memorandums we reviewed had signature blocks for both the contract specialist and the contracting officer (generally the preparer and reviewer, respectively) the memorandums were not always signed by the contracting officer.

Contract Review Board Not Effective in Ensuring Proper Contract Award Actions

CMS's OAGM established the Contract Review Board (CRB) reviews as a key control procedure to help ensure contract award actions are in conformance with law, established policies and procedures, and sound business practices. However, our review of the CRB process found that the process had not been properly or fully implemented. For example, of the 22 contracts selected to be reviewed by the CRB in 2008, only 7 were actually reviewed. Similarly, for fiscal year 2009, 22 contracts were selected for the CRB but only 2 have been reviewed as of the end of the third quarter. Also, the contracting officer for the contract action being reviewed is neither required to reach consensus with the CRB on the resolution of issues identified nor to document the justification for not resolving CRB issues. Moreover, CMS is not following its policies for selecting the contracts to be reviewed by the CRB. While OAGM's policies require that all contracts above \$10 million be subjected to the CRB, CMS confirmed that only contracts nominated by division directors are reviewed. If used correctly, the CRB can be an effective tool for risk-based quality assurance and for reviewing the internal controls throughout the contract award and administration process. However, because CMS policies do not require issues to be resolved and documented and because CMS is not fully implementing the CRB, opportunities to identify and fix

⁴⁶ 48 CFR § 315.372.

deficiencies in the contract administration process and to improve internal controls may be missed.

Weak Control Environment Hinders CMS's Ability to Manage its FAR-based Acquisition Process

In addition to the deficiencies in contract-level control procedures as discussed previously, CMS's FAR-based contract management was impaired by a weak control environment. CMS's control environment is characterized by the lack of strategic planning to identify necessary staffing and funding, a lack of reliable data for effectively carrying out contract management responsibilities, very limited actions taken on the recommendations we made in 2007 related to contracting and payments to contractors, and a lack of procedures for managing contract audits which are essential to managing and overseeing the growing value of contracting activities. A positive control environment sets the tone for the overall quality of an entity's internal control, and provides the foundation for an entity to effectively manage contracts and payments to contractors. Without a strong control environment, the control deficiencies we identified during this review will likely persist.

OAGM Management Has Not Determined CMS Contract Management Staffing and Funding Resource Requirements

OAGM management has not analyzed its contract management workforce and related funding needs through a comprehensive, strategic acquisition workforce plan. Such a plan is critical to help manage the increasing acquisition workload and meet its contracting oversight needs. We reported in November 2007⁴⁷ that staff resources allocated to contract oversight had not kept pace with the increase in CMS contract awards. A similar trend continued into 2008. While the obligated amount of contract awards has increased 71 percent since 1998, OAGM staffing resources—its number of full time equivalents (FTE)—has increased 26 percent. This trend presents a major challenge to contract award and administration personnel who must deal with a significantly increased workload without additional support and resources.

While CMS has data on its workforce changes since January 2007 (attritions and additions), documentation requesting additional FTEs for a specific project, and, in its fiscal year 2010 budget, a request to hire contract support staff to help meet contract and grant administration needs, CMS has not yet determined the amount of total FTEs needed for the fiscal year and beyond. For example, the documentation did not

⁴⁷ [GAO-08-54](#), p. 18.

contain an analysis of the workload anticipated for the year, such as the total number of new awards, the number of active contracts by contract type, the number of CMS contracts under HHS's cognizance, or the number and type of audits needed. The documents did not contain information on CMS's current FTE level, skill mix, or analysis of any skill gaps. Without this information, OAGM has limited insight into appropriate solutions, such as the use of contractor support staff. While the use of contractor support staff has in recent years become commonplace in the federal government, we have previously reported⁴⁸ that using contractors for contract administrative functions may increase the risk of establishing unauthorized personal services contracts or the risk of contractors performing inherently governmental functions, both of which are prohibited by FAR.⁴⁹

According to its staff and management, OAGM is challenged to meet the various audit requirements necessary to ensure adequate oversight of contracts that pose more risk to the government, specifically cost reimbursement contracts, as well as perform the activities required of a CFA. While officials told us they could use more audit funding, we found that OAGM management had yet to determine what an appropriate funding level should be. Without knowing for which contractors additional CFA oversight is needed, CMS does not know with certainty the number of audits and reviews that must be performed annually or the depth and complexity of those audits. Without this key information, CMS can not estimate an adequate level of audit funding that it needs.

During interviews and our on-site review of contract files, we were told by OAGM senior management and contracting officers and specialists that the first set of activities that the contracting officers and specialists tend to neglect under resource constraints was post-award administration and contract closeout. Moreover, while OAGM management told us that staff worked hard to comply with its instructions to follow all applicable FAR requirements, CMS staff told us they take shortcuts due to resource constraints. For example, one contract specialist told us she prepared the Independent Government Cost Estimate based on the winning contractor's proposed costs instead of conducting her own independent research to determine the government's benchmark for the reasonableness of the costs of the scope of work. Additionally, as previously discussed, CMS

⁴⁸ [GAO-08-360](#).

⁴⁹ 48 C.F.R. §§ 37.104(b) and 37.102(c).

officials told us that incurred cost audits are not performed annually primarily due to insufficient resources. A shortage of financial and human resources creates an environment that introduces vulnerabilities to the contracting process, hinders management's ability to sustain an effective overall control environment, and ultimately increases risk in the contracting process.

CMS Lacks Reliable Data Needed to Effectively Carry Out Contract Management Responsibilities

Although CMS has generally reliable information on basic attributes of each contract action, such as vendor name and obligation amount, CMS lacks reliable management information on other key aspects of its FAR-based contracting operations, including the number of certain contract types awarded, the extent of competition achieved, and total contract value. Standards for internal control provide that for an agency to manage its operations, it must have relevant, reliable, and timely information relating to the extent and nature of its operations, including both operational and financial data, that should be recorded and communicated to management and others within the agency who need it and in a form and within a time frame that enables them to carry out their internal control and operational responsibilities. The acquisition data errors are due in part to a lack of sufficient quality assurance activities over the data entered into the acquisition databases. Without accurate data, CMS program managers do not have adequate information to identify and monitor areas that pose a high risk of improper payments or waste. Moreover, inaccurate or incomplete data hinder CMS's ability to mitigate through additional policies or enhanced oversight any high-risk areas, such as the frequent use of cost reimbursement contracts, that would be identified based on reports or analysis of the databases. The errors in DCIS, including the unrecorded actions, also impact governmentwide reporting. The Office of Management and Budget (OMB) requires agencies to submit their acquisition data to the Federal Procurement Database System-Next Generation (FDPS-NG). Since HHS submits DCIS data to the FDPS-NG, which in turn feeds into OMB's publicly available database at www.usaspending.gov, the DCIS errors noted above are provided to the public and limit the usefulness and transparency of this important tool.

- **We estimate that for at least 34.9 percent of fiscal year 2008 contract actions,⁵⁰ PRISM contained at least one error in the**

⁵⁰ Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 34.9 percent.

selected critical fields we reviewed. In particular, we found that PRISM contained 16 errors in a field we reviewed that designated the extent to which the contract was competed, for example, full and open competition or not competed as a result of being a logical follow-on to a previous contract. Additionally, we determined that the award type field in PRISM did not capture consistent information. For example, the field had prepopulated options associated with both award type (basic ordering agreement, delivery order, letter contract, etc.) and contract type (cost reimbursement, fixed price, and T&M). Combining these options into one data field prevents CMS from determining the total number of each award type and each contract type, making it difficult to accurately determine CMS's contracting trends. OAGM officials told us that the data entered into PRISM are not subjected to a secondary review in which the data entered are compared to the information in the contract file.

- **We estimate that for at least 54.2 percent of fiscal year 2008 contract actions,⁵¹ DCIS contained at least one error in the selected critical fields we reviewed.** DCIS contained errors in current contract value and ultimate contract value fields,⁵² as well as the extent of competition, contract type, and award type fields. Further, 11 sample items, or approximately 10 percent of the sample, were not in DCIS. Our high-level data analysis on the population of fiscal year 2008 contract actions identified that certain required fields, such as contract type and competition, contained blank responses and “nulls”. We also noted obvious errors. For example, CMS entered codes for “potato farming” and “tortilla manufacturing” in the industry code field for two contract actions.

Prior to calendar year 2008, CMS did not have quality assurance activities, such as formal data entry reviews or database training, over the data contained in the DCIS database. In December 2007, OAGM established a Verification and Validation Plan for DCIS Accuracy Improvements (V&V). The V&V plan contained several actions, including a secondary review of data entered into DCIS for every 50th contract action. The V&V plan lacks key elements and controls to

⁵¹ Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least 54.2 percent.

⁵² The current contract value field is supposed to capture the cumulative obligated amounts on the contract to date and ultimate contract value is supposed to capture the current contract value plus anticipated future obligations, i.e., option years.

ensure that the resolution of potential errors is properly documented and errors are corrected in a timely manner. For example, OAGM officials could not determine if all errors identified during the file reviews were properly resolved and the appropriate adjustments to DCIS were made. Additionally, while staff training was provided in January 2008, the DCIS data entry instructions were later modified with new information. In one instance, we noted that the DCIS preparer and the reviewer were using different versions of the instructions resulting in confusion over what would be the appropriate DCIS entry. OAGM officials provided us with the results for the V&V plan for 2008, which showed that 23 of the total 2,031 contract actions entered into DCIS in 2008 were reviewed for accuracy, which is approximately every 88th action.

Seven of Nine GAO 2007 Recommendations Remain Substantially Unresolved

As of July 22, 2009, CMS management had not taken substantial actions to address our prior recommendations to improve internal control in the contracting process. Only two of GAO's nine 2007 recommendations had been fully addressed. Table 1 summarizes, and appendix II provides additional detail on, our assessment of the status of CMS's actions to address our recommendations. The seven substantially unresolved recommendations represent a lack of action on the part of CMS management to resolve key control deficiencies.

Table 1: GAO Assessment of Status of CMS Actions Taken to Address 2007 Recommendations

	GAO recommendation	GAO assessment of status
(1)	Develop policies and criteria for pre-award contract activities.	No action taken.
(2)	Develop policies and procedures to help ensure that cognizant federal agency responsibilities are performed.	Actions insufficient. No policies or procedures developed. See discussion below.
(3)	Develop agency-specific policies and procedures for the review of contractor invoices so that key players are aware of their roles and responsibilities.	Completed.
(4)	Prepare guidelines to contracting officers on what constitutes sufficient detail to support amounts billed on contractor invoices to facilitate the review process.	No action taken.
(5)	Establish criteria for the use of negative certification in the payment of a contractor's invoices to consider potential risk factors.	No action taken.

GAO recommendation	GAO assessment of status
(6) Provide training on the invoice review policies and procedures to key personnel responsible for executing the invoice review process.	Actions taken do not achieve intent of recommendation. Training was provided; however, invoice review policies have not yet been sufficiently revised to address our recommendations.
(7) Create a centralized tracking mechanism that records the training taken by personnel assigned to contract oversight activities.	Completed.
(8) Develop a plan to reduce the backlog of contracts awaiting closeout.	Actions insufficient. See discussion below.
(9) Review the questionable payments identified in this report to determine whether CMS should seek reimbursement from contractors.	Actions insufficient. See discussion below.

Source: GAO.

- Policies and criteria for pre-award contract activities have not been developed.** In our 2007 report, we recommended that CMS develop policies for certain pre-award contract activities, such as analysis to justify the contract type selected and verification of the adequacy of the contractor’s accounting system prior to the award of a cost reimbursement contract. However, no new policies or guidance were developed, because in CMS’s view, policies and criteria are already established in the FAR and HHSAR. While the FAR provides requirements for federal acquisitions, it is up to the agencies to develop and provide their contracting workforce with specific policies and day-to-day procedures that guide them in implementing those requirements and to tailor the policies to address the specific operational environment. Agency-specific policy may include guidance on applicable approval levels, time frames, agency forms, and routing processes. Also, while the HHSAR provides additional guidance and policies specific to HHS, the HHSAR does not specifically address all of the pre-award contract activities that we identified as needing improvement, nor does it delineate the roles and responsibilities of the different staff involved in the contracting process or establish time frames for when certain pre-award contract activities should be performed. The deficiencies identified in this report, especially those associated with FAR requirements unique to specific contract types, further highlight the need for additional guidance for contracting officers.
- Roles and responsibilities for implementation of CFA responsibilities not clearly defined.** The FAR requires that CFAs perform certain oversight and monitoring activities. The CFA concept provides an efficient way for contractors to receive a streamlined set of audits and reviews, thereby enabling them to receive and perform government contracts. In our 2007 report, we found that CFA

responsibilities were inadequately fulfilled and recommended that CMS develop policies and procedures to ensure that CFA responsibilities were performed. In a recommendation resolution report, HHS stated that policies and procedures were needed at both the department level and at CMS. As of July 2009, neither HHS nor CMS had developed such policies and procedures or a mechanism to track the CMS contractors for which additional oversight is needed. Moreover, roles and responsibilities for the performance of CFA duties were not clear among HHS and its components, including CMS.

During an interview with CMS, HHS, NIH, and HHS Office of Inspector General (OIG) officials, HHS officials stated that CFA responsibilities lie at the HHS department level. However, HHS officials also said that certain CFA responsibilities are delegated to HHS components and to contracting officers. Specifically, NIH was assigned responsibility to establish indirect rates for the contractors under HHS's cognizance, but contracting officers within HHS components are responsible for other CFA duties. However, during the meeting, the officials could not clearly explain how the performance of these duties was monitored to ensure that CFA oversight takes place. HHS officials said that they did not have a process to identify the contractors, including CMS contractors, for which HHS would be the CFA. Without a list that is periodically updated for the contractors' portfolio of federal government contracting activity, HHS and its components do not know the contractors for which CFA oversight is needed.

NIH officials acknowledged their centralized role in determining indirect rates, but noted that NIH did not have the resources necessary to determine the indirect rates for the contractors under HHS's cognizance. CMS officials told us that when NIH can not perform the reviews within the needed time frames to make timely contract awards, CMS's cost/price team establishes the rates. The confusion over roles and responsibilities increases the risk that CFA responsibilities are not being timely performed, if at all. Without effective coordination, contractors may not receive the necessary oversight and the government may not be positioned to protect itself from the risk of improper payments or waste. The risks of not performing CFA duties are exacerbated by the fact that other federal agencies that use the same contractors rely on the oversight and monitoring work of the CFA.

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- **CMS policies did not provide guidance on what constitutes sufficient detail to support amounts billed on contractor invoices to facilitate the review process.** Despite our prior recommendation, CMS had not prepared guidelines or revised its invoice review policy to specify or provide examples of sufficient detail that would be needed to support contractor invoices to facilitate an adequate review. In fact, most of the invoices we reviewed were not sufficiently supported. We identified invoices missing payroll detail, travel receipts, and subcontractor invoices, all of which are necessary to provide the reviewers adequate information to confirm if the amounts billed were compliant with the terms of the contract or otherwise allowable and allocable to that contract. In one instance, invoices reported labor costs based on labor categories, but did not show hours worked by employees or their respective labor rates. In another example, a contractor submitted an invoice in 2008 for services that were provided in 2003. The contractor did not provide supporting documentation for the \$36,944 billed. Neither the invoice paid in 2008, nor the related file included evidence that the charge was investigated or further evaluated by either the project officer or contracting specialist. While different levels of review may be required based on the complexity of individual invoices and associated contract type, inadequately reviewing invoices increases the risk of improper payments.
 - **CMS has not set criteria for the use of negative certification.** We recommended in our 2007 report that CMS establish criteria for the use of negative certification in the payment of contractor invoices which would consider potential risk factors. CMS uses negative certification—a process whereby it pays contractor invoices without knowing whether they were reviewed and approved—in order to ensure invoices are paid in a timely fashion. This approach, however, significantly reduces the incentive for contracting officers, specialists, and project officers to review the invoice prior to payment. Reviewing invoices prior to payment is a preventive control which may result in the identification of unallowable billings, especially on cost reimbursement and T&M invoices, before the invoices are paid. In light of the importance of this preventive control, we recommended that CMS establish criteria for when to use negative certification; such criteria may be based on considerations of potential risk factors such as contract type, the adequacy of the contractor’s accounting system, and prior history with the contractor. We found, however, that OAGM’s invoice review policy was not revised to address this recommendation and OAGM officials confirmed that negative

certification is still the primary method for paying invoices regardless of risks.

- **Training on invoice review procedures still needed.** As discussed earlier, project officers did not always certify invoices for approval and contracting officers or specialists did not always identify instances where invoices did not comply with contract terms and conditions. We also found that invoices were not always maintained in the file, as required by CMS's invoice review policy. In light of these continuing deficiencies, and the need for further revisions to its invoice review policy described above, further training on invoice review procedures will be necessary.
- **Continuing backlog of contracts overdue for closeout.** In 2007, we reported that CMS did not timely perform contract closeout procedures resulting in a backlog of 1,300 contracts, of which 407 were overdue for closeout as of September 30, 2007. We recommended that CMS develop a plan to reduce the number of contracts in the backlog. CMS did not provide us a closeout plan for fiscal year 2008 and the fiscal year 2009 plan was insufficient. Specifically, the plan did not include a comprehensive strategy to reduce the backlog of contracts that are eligible and overdue for closeout nor did it contain a workload analysis, such as a list of contracts eligible for closeout by contracting officer or specialist or an estimate of the number of hours or audit funds it would need to close the contracts.

The FAR establishes time standards for closing out a contract after the work is physically completed (i.e., goods or services are provided).⁵³ The contract closeout process is an important internal control, in part, because it is generally the last opportunity for the government to detect and recover any improper payments. The complexity and length of the closeout process can vary with the extent of oversight performed by the agency during the period of performance and the contract type.⁵⁴

⁵³ 48 C.F.R. § 4.804.

⁵⁴ 48 C.F.R. § 4.804 states that firm fixed price contracts should be closed within 6 months; contracts requiring the settlement of indirect costs rates, such as cost reimbursement contracts, should be closed within 36 months; and all other contracts should be closed within 20 months. These time frames begin in the month in which the contracting official receives evidence of physical completion of the contract. Generally, files for contracts using simplified acquisition procedures should be considered closed when the contracting officer receives evidence of receipt of property and final payment.

CMS officials told us that during fiscal year 2008, OAGM closed 581 contracts and reduced the overdue backlog to 400 contracts (from the 407 reported at the end of fiscal year 2007).⁵⁵ Yet OAGM officials could not provide support for these closures or a list of the contracts overdue for closeout. Additionally, CMS officials stated that as of July 29, 2009, the total backlog of contracts eligible for closeout was 1,611, with 594 overdue based on FAR timing standards. This is a substantial increase over the balances at the end of fiscal year 2007. Moreover, the total contract value of contracts eligible for closeout has increased from \$3 billion to at least \$3.8 billion.

Insufficient progress has been made to reduce the backlog of contracts eligible for closeout. The closeout process is particularly important for cost reimbursement contracts because a contractor is allowed to bill costs it incurred to provide the good or service. During the closeout process, the government audits these billed costs to determine if they were allowable and allocable to the contract, and processes the final invoice with an adjustment for any over- or underpayments. The failure to perform contract closeouts in a timely manner puts CMS at increased risk of improper payments or waste, and may make identification and recovery of any such improper payments more difficult due to the passage of time.

- **CMS has not taken sufficient actions to investigate and recover questionable payments.** CMS described several actions it has taken to investigate payments made to 3 of the 12 contractors for which we identified questionable payments. The actions CMS has taken to date are insufficient to fully resolve the issues identified and more remains to be done to recover funds that may have been inappropriately paid to contractors.

For example, CMS highlighted \$67 million in questionable payments that were related to one specific contractor and stated that these questionable payments are being investigated via a fiscal year 2008 incurred cost audit. However, the \$67 million related to costs incurred in fiscal years 2004, 2005, and 2006 and therefore would not be covered or investigated in an audit of fiscal year 2008 incurred costs. Additionally, CMS said it had resolved the questionable payments made to another contractor; however, CMS's actions did not relate to the \$1.4 million in payments CMS made in fiscal year 2006 that we

⁵⁵ [GAO-08-54](#), p. 31.

questioned. Regarding a third contractor, CMS issued a demand letter in April 2007 to recover funds the contractor billed and CMS paid in excess of contract ceiling limits; however, no resolution has yet been reached. CMS could not tell us whether it had recovered any of the questioned amounts.

CMS's resolution of questionable payments of the magnitude we identified (\$88.8 million) in the prior report should be performed expeditiously. As a steward of taxpayer dollars, CMS is accountable for how it spends and safeguards funds as well as having mechanisms in place to recoup those funds when improper payments are identified. CMS relies on incurred cost audits that are conducted at the end of contract performance when the contract is closed to validate the overall propriety of payments. As discussed earlier, incurred cost audits are best conducted annually, rather than at the end of contract performance. CMS's backlog of contracts eligible for closeout delays investigations and makes recovery more difficult.

CMS Does Not Track, Investigate, and Resolve Contract Audit and Evaluation Findings to Aid Decision Making

CMS does not track, investigate, and resolve contract audit and evaluation findings for purposes of cost recovery and future award decisions. Tracking audit and evaluation findings strengthens the control environment in part because it can help assure management that the agency's objectives are being met through the efficient and effective use of the agency's resources. It can also help management determine whether the entity is complying with applicable acquisition laws and regulations. Contract audits and evaluations can add significant value to an organization's oversight and accountability structure, but only if management ensures that the results of these audits and evaluations are promptly investigated and resolved.

During our review of the contract files, we noted that audits and evaluations CMS requested of organizations such as DCAA or performed by the CMS cost/price team identified questionable payments, accounting system deficiencies, and other significant weaknesses or deficiencies associated with certain CMS contractors. However, we could not consistently determine how the contracting officer or other OAGM staff followed up on the results of these audits and noted that CMS was not always taking the results of these audits and evaluations into consideration when making decisions relating to future contract awards.

For example, in an audit report dated September 30, 2008, DCAA questioned approximately \$2.1 million of costs that CMS paid to a contractor in fiscal year 2006. OAGM management confirmed that no

action has been taken to investigate and recover the challenged costs. In another instance, the contracting officer—based on the results of a cost/price team evaluation of a contractor’s technical capability and negative results of DCAA audits—deemed the contractor “risky” during the pre-award contract proposal evaluation process. Nevertheless, the contracting officer awarded the cost reimbursement contract to this “risky” contractor. We found no evidence of any plans or procedures that would mitigate the identified risks.

CMS has not established a formal procedure or system for tracking and pursuing the results of contract or contractor audits and had not provided its contracting officers guidance or procedures for when to request the assistance of internal and external audit and evaluation services. For example, OAGM did not provide direction on when (what stage(s) in the contract life cycle and under what circumstances) the contracting officer should utilize the service of the cost/price team or other contract auditors. By not timely acting on audit results or fully incorporating knowledge identified by cost/price evaluations or other audits into award decisions, CMS is forgoing the potential benefits from those audits and evaluations. A well-established tenet for recovery of improper payments is that it becomes increasingly more difficult with the passage of time. Careful and prompt consideration of audit results, including tracking and pursuing findings, helps to reduce the risk of improper payments or waste, and making other-than-the-best award decisions.

Conclusion

The contract-level and overall control environment weaknesses we found significantly increase CMS’s vulnerability to improper or wasteful contract payments. To address these deficiencies, CMS will need to develop and implement CMS-specific policies and procedures to ensure that contract actions are properly administered and comply with applicable requirements. CMS also needs to strengthen its overall contract management control environment, including developing strategic workforce plans, establishing appropriate contract management oversight procedures, and maintaining reliable management information.

In addition, CMS management has made limited progress in substantively addressing most of the broad-based recommendations from our 2007 report. We found that many of our findings in this review could be, at least in part, attributed to CMS management’s lack of attention given to resolving the control deficiencies. Consequently, we are reiterating our previous recommendations to (1) develop policies for pre-award contracting activities, (2) develop policies to help ensure CFA

responsibilities are performed, (3) prepare guidelines on what constitutes sufficient detail to support contractor invoices, (4) establish criteria for the use of negative certification, (5) provide training on revised invoice review policies, (6) develop a plan to reduce the backlog of contracts eligible for closeout, and (7) review the questionable payments identified in the prior report to determine if payments are recoverable.

The continuing weaknesses in contracting activities and limited progress in addressing known deficiencies raise questions concerning whether CMS management has established an appropriate “tone at the top” regarding contracting activities. Until CMS management addresses our previous recommendations in this area, along with taking action to address the additional deficiencies identified in this report, its contracting activities will continue to pose significant risk of improper payments, waste, and mismanagement. Further, the deficiencies we identified are likely to be exacerbated by the rise in obligations for non-claims processing contract awards as well as CMS’s extensive reliance on contractors to help achieve its mission objectives. It is imperative that CMS take immediate action to address its serious contract-level control deficiencies and take action on our previous recommendations to improve contract-level and overall environment controls or CMS will continue to place billions of taxpayer dollars at risk of fraud, or otherwise improper contract payments.

Recommendations for Executive Action

We make the following nine recommendations to the Administrator of CMS to develop and implement policies and procedures to ensure that FAR requirements and other control objectives are met. Policies and procedures should:

- Document compliance with FAR requirements for different contract types. At a minimum, enhance current documentation, such as the contract checklist, to ensure the contract file documents authorizations for letter contracts, adequacy of the contractors accounting systems, and determination and findings for time and materials contracts, when applicable.
- Document in the contract file provisional indirect cost rates used as a basis for reviewing the reasonableness of the indirect costs billed on the contractor invoices.
- Specify what constitutes timely performance of (or request for) audits of contractors’ statements of incurred cost for cost reimbursement and T&M contracts, including circumstances when OAGM should

perform the audit itself or request another organization to perform the service.

- Specify circumstances under which negotiation memorandums should be used and the content of such, and any required secondary reviews, in light of HHSAR requirements and current OAGM practice.
- Specify Contract Review Board review documentation to include, at a minimum, documentation of the number of contracts reviewed each year, the issues identified by the CRB reviewer(s), and resolution of issues identified during the CRB reviews.
- Require Division Directors to periodically assess, document, and report to senior management on the results of their review of whether the contract files contain documentation that invoices were properly reviewed by both the project officer and contracting officer or specialist.

To strengthen the control environment, we recommend that OAGM management:

- Develop and implement a comprehensive strategic acquisition workforce plan. The plan should include, at a minimum, elements such as performance goals, time frames, implementation actions, and resource requirements, and address issues such as OAGM workload, full time equivalents needed, and a workforce skills analysis, as well as an estimate of the amount of resources OAGM needs to fulfill the audit and other FAR requirements for comprehensive oversight, including those required of a CFA.
- Revise the Verification and Validation Plan for DCIS Accuracy and Improvements policy to require all relevant errors be corrected and their resolution documented.
- Develop and implement policies and procedures for tracking contract audit requests, monitoring the results of contract audits and evaluations, and resolving the audit findings, to include roles and responsibilities of the contracting officer, specialist, and members of the cost/price team.

We make the following recommendation to the Secretary of HHS to improve the department's fulfillment of CFA duties as described in FAR.

- Develop policies and procedures that clearly assign roles and responsibilities for the timely fulfillment of CFA duties, and that include the preparation of and periodic update of a list of contractors for which the department is the CFA.

Agency Comments and Our Evaluation

In written comments on a draft of this report (reprinted in their entirety in appendix III), CMS and HHS agreed with each of our 10 new recommendations and described steps planned to address them. CMS also stated that the recommendations will serve as a catalyst for improvements to the internal controls for its contracting function. In its comments, CMS also expressed concerns about the scope and timing of our work with respect to our November 2007 recommendations and disagreed with our assessment of the status of 5 of the 7 recommendations we made in that report. We address the concerns CMS raised in its comment letter below and include additional information at the end of appendix III.

In its comments, CMS stated its belief that the 11 internal controls we reviewed did not provide a complete picture of its internal controls over contract management activities. We acknowledge that there are many internal controls that are and can be instituted by agencies to help safeguard assets, prevent and detect fraud and errors, and help government program managers achieve desired results through effective stewardship of public resources. As described in appendix I, we selected 11 controls that we determined to be "key" based on GAO's standards for internal control, the FAR and HHSAR, CMS's policies and procedures, and other factors including our prior audit findings regarding CMS's acquisition controls and the nature of CMS's acquisition function.

CMS stated its belief that "virtually all" of the errors we identified related to "perceived documentation deficiencies." CMS stated it was encouraged that the errors we found did not involve more substantive departures from the FAR or HHSAR. We disagree with CMS's overall assessment of our findings and message of the report. The internal controls we tested are key to ensuring that contracting activities, both pre-award and post-award, mitigate risks to the federal government. A number of the findings we identified during the testing of a statistically valid sample of contract files involved the lack of documentation that the controls were performed. Lack of documentation reduces management's ability to ascertain whether these important controls were appropriately implemented and therefore is

a serious internal control deficiency. OAGM management's downplaying of the overall message of the report—that control deficiencies are pervasive—further illustrates the weak internal control environment. Setting an appropriate control environment, especially “tone at the top,” is key to ensuring that staff take all appropriate steps to mitigate risk and protect tax dollars from fraud, waste, and abuse.

CMS also stated that a reasonable amount of time had not yet elapsed since the issuance of our November 2007 report to allow for corrective actions to have taken place. A significant number of our current report findings, including weaknesses in the control environment, were based on observations and interviews with OAGM officials and reviews of related documentation such as policies and strategic plans. Our current review was completed in September 2009, nearly 2 years after the issuance of our November 2007 report. While CMS also stated that the contract actions we reviewed took place in fiscal year 2008, it is important to note that we considered the timing of CMS's corrective actions when evaluating the controls we tested. For example, CMS's Acquisition Policy 02-03, which identifies level of approvals required by agency officials based on the estimated dollar value for acquisitions awarded through other than full and open competition, was implemented in April 2008. We applied these approval levels only to the awards and modifications in our sample that were made after the policy was implemented. Furthermore, our observations and recommendations related to CMS's control environment are based on conditions that continued to exist in September 2009.

CMS disagreed with our determination that their actions to address five of the seven prior recommendations were not sufficient. These prior recommendations were aimed at improving preventive controls. Preventive controls, such as policies and criteria for pre-award activities and a sound invoice review process prior to payment, are the first line of defense in reducing the risk of improper payments or waste. We continue to believe that the limited actions OAGM management has taken, and in some cases, management's inaction, fall short of expectations and miss the intent of improving CMS's overall system of control over its acquisition activities.

For example, CMS asserted that its Acquisition Policy 16-01 entitled “Invoicing Payment Procedures” satisfies two of the prior recommendations. The intent of these two recommendations was to ensure that contractors provided adequate support to facilitate an appropriate detailed review of the invoiced costs prior to payment and that CMS develop clear risk-based criteria for the use of negative

certification. CMS uses negative certification—a process whereby it pays contractor invoices without knowing whether they were reviewed and approved—in order to ensure invoices are paid in a timely fashion. We examined this policy during our review and found it to be unresponsive to the recommendations because it did not provide the recommended additional guidelines on what the contractor should provide that would constitute sufficient detail to support amounts billed on contractor invoices. It also did not describe under what circumstances or in what situations it was acceptable for CMS to use negative certification.

With regard to a third prior recommendation that CMS review the questionable payments we identified, CMS described in its comment letter specific actions taken to investigate some of the questionable payments and subsequently provided documentation of actions it had taken to investigate the questionable payments we identified for three contractors. After reviewing this information, we revised our assessment of the status of efforts taken by CMS from “No Actions Taken” to “Actions Insufficient.” While CMS had taken some action, the steps have not resolved the questionable payments we identified. For example, CMS highlighted \$67 million that we previously questioned that was related to one specific contractor and stated that these questionable payments are being investigated via a fiscal year 2008 incurred cost audit. The \$67 million we questioned related to costs incurred in fiscal years 2004, 2005, and 2006 and therefore would not be covered or investigated in an audit of fiscal year 2008 incurred costs. Moreover, as of the date of the report, CMS could not tell us whether it had recovered any of the questioned amounts. We continue to believe that CMS’s actions to date are insufficient and more actions are needed to investigate and recover the questionable payments we identified.

No other changes were made to the report as a result of agency comments. See appendix III for a discussion of the remaining two prior recommendations (points 2, 3, and 4) for which CMS disagreed with our assessment of its progress and our analysis of comments CMS made on our new recommendations.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its date. At that time, we will send copies to the Secretary of Health and Human Services, Administrator of the Centers for Medicare and Medicaid Services, and interested congressional committees. Copies will also be

available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9095 or dalykl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report are acknowledged in appendix IV.

A handwritten signature in black ink that reads "Kay L. Daly". The signature is written in a cursive style with a large, stylized initial 'K'.

Kay L. Daly
Director
Financial Management and Assurance

List of Requesters

The Honorable Max Baucus
Chairman

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable Henry A. Waxman
Chairman
Committee on Energy and Commerce
House of Representatives

The Honorable Edolphus Towns
Chairman
Committee on Oversight and Government Reform
House of Representatives

The Honorable Claire McCaskill
Chairman
Ad Hoc Subcommittee on Contracting Oversight
Committee on Homeland Security and Government Affairs
United States Senate

Appendix I: Scope and Methodology

To determine the extent to which the Centers for Medicare and Medicaid Services (CMS) implemented effective internal control procedures over contract actions, we focused on contracts that were generally subjected to the Federal Acquisition Regulation. We also interviewed senior management of CMS's Office of Acquisition and Grants Management (OAGM), contracting officers and specialists, and cost/price team members as well as officials in the Office of Acquisition Management and Policy at the Department of Health and Human Services (HHS). We selected 11 internal controls over contracting and payments to contractors to test for this report, ranging from ensuring contractors had adequate accounting systems prior to the use of a cost reimbursement contract to certifying invoices for payment. We selected controls to test based on our review of GAO's standards for internal control,¹ the Federal Acquisition Regulation requirements, and agency policies and procedures, taking into consideration prior audit findings and the contract types most frequently awarded. The controls we tested are key to effective administration of the contract in that the lack of implementation would significantly increase the risk of improper payments or waste.

To test internal control procedures over contract actions, we selected a stratified random sample of 102 contract actions totaling \$140.7 million in fiscal year 2008 obligations from a population of 2,441 contract actions totaling \$2.5 billion in fiscal year 2008 obligations. We stratified the contract actions by type of action, namely contract awards and contract modifications, recorded in CMS's PRISM database from October 1, 2007, through September 30, 2008. Each contract action was either a new contract award or modification to an existing contract. With this probability sample, each contract action in the sample frame had a non-zero probability of being included and that probability could be computed from any contract action. Each stratum was subsequently weighted in the analysis to account statistically for all the contract actions in the sample frame, including those that were not selected. Results from this statistical sample were projected to the population of contract actions made from October 1, 2007, through September 30, 2008. See table 2 for specific details related to contract actions selected in the sample.

¹ GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

Table 2: Contract Actions in the Sample

Contract type	Awards		Modifications		Total	
Cost reimbursement	14	\$19,343,733	39	\$71,718,383	53	\$91,062,116
Fixed price	17	\$2,527,049	6	\$1,054,274	23	\$3,581,323
Time and materials	11	\$11,590,778	10	\$6,921,590	21	\$18,512,367
Combination ¹	0	\$0	5	\$27,593,568	5	\$27,593,568
	42	\$33,461,560	60	\$107,287,815	102	\$140,749,375
Source Selection						
Full and open	14	\$15,443,355	40	\$98,426,529	54	\$113,869,884
Logical follow-on	4	\$2,177,215	6	\$2,354,367	10	\$4,531,582
Only one supplier	9	\$2,130,305	6	\$1,427,131	15	\$3,557,436
8(a) ²	3	\$2,096,448	2	\$421,958	5	\$2,518,406
Other ³	12	\$11,614,238	6	\$4,657,829	18	\$16,272,067
	42	\$33,461,560	60	\$107,287,815	102	\$140,749,375

Source: PRISM.

¹ “Combination” represents contracts that are a combination of multiple contract types.

² “8(a)” represents a source selection made to a contractor in the Small Business Administration’s (SBA) 8(a) program. Contracts awarded to 8(a) contractors do not require competition if the award is below certain dollar thresholds and is approved by an SBA official.

³ “Other” represents other source selections, such as acquisitions that are authorized by statute (not competed).

We evaluated contract actions that varied in amount of dollars obligated, contract type (fixed price, cost reimbursement, etc.), and the type of goods and services procured. The actions in the sample ranged from a \$1,000 firm-fixed price contract for newspapers to a \$17.5 million modification of an information technology contract valued at over \$500 million. We reviewed the contract files supporting actions in the sample and, as needed, interviewed and solicited further information from the contracting officer or specialist, CMS’s cost/price team, and senior management. Controls were considered to be implemented if the performance of the control was documented in either the contract file or centrally with the cost/price team or if the contracting officer or specialist provided us with supplementary documentation or other evidence that the control was performed. The 11 controls we tested may not apply to all contract actions selected in the sample. For example, having support for provisional indirect cost rates is required for cost reimbursement contracts but not for other contract types, such as fixed price contracts. In these instances, we designated the control to be “not applicable” to the

sample item. Table 3 provides further details on the control procedures we tested, the criteria or source for the procedure, and detailed results.

Table 3: Control Procedures and Detailed Results

Internal controls	Criteria/source	Number of errors in the sample	Number of sample items to which the control applied ¹	Estimated lower error limit of all FY 2008 CMS contract actions that did not meet the control test ²
1 If the contract action relates to a modification, did CMS properly support and justify the action (e.g., was the action within the scope of the underlying contract)?	It is important for agencies to determine if a modification is within the general scope of the contract to help ensure compliance with Federal Acquisition Regulation (FAR) 43-201(a), FAR 6.001(c), and applicable contract funding rules. Further, contract file documentation shall be sufficient to constitute a complete history of the contract for the purpose of: (1) providing a complete background as a basis for informed decisions at each step in the acquisition process, (2) supporting actions taken, (3) providing information for reviews and investigations, and (4) furnishing essential facts in the event of litigation or congressional inquiries. FAR 4.801(b); see also FAR 4.803(a)(26)(iii).	5	60	3.4 %
2 For contracts awarded through other than full and open competition, was the justification documented, approved by the appropriate official, and does it meet the FAR criteria (e.g., FAR 6.302) for using other than full and open competition?	FAR 6.303-1 through 6.304. FAR 16.505(b)(5) FAR 13.106-1(b)(1) CMS's Acquisition Policy Notice 02-03	5	19	11.3%
3 Is there evidence that the contracting officer reviewed the contractor's proposals for price reasonableness?	FAR 15.404-1(a)(1) FAR 15.305 (a)(1) FAR 4.803(a)(19)	11	40	16.5%
4 Did CMS include documentation in the file that supports its determination that the contractor is "responsible" to perform under the contract?	FAR 9.103(a) FAR 9.105-2(b) FAR 4.803(a)(14)	16	39	28.0%

Appendix I: Scope and Methodology

Internal controls	Criteria/source	Number of errors in the sample	Number of sample items to which the control applied ¹	Estimated lower error limit of all FY 2008 CMS contract actions that did not meet the control test ²
5 Did CMS comply with and document the requirements unique to the contract type awarded?	FAR 16.301-3(a)(1) FAR 16.104(h) FAR 16.601(d)(1) FAR 1.704 Health and Human Services Acquisition Regulations (HHSAR) 316.603-71 FAR 4.803(a)(2) and (22)	16	25	46.0%
6 When applicable, did CMS conduct a technical panel? If issues were identified by the technical panel or during the price reasonableness evaluation under control # 3 in this table, did CMS clearly and sufficiently document how the issues were addressed prior to the award of the contract?	Per FAR 15.304(c)(2), agency acquisition officials are required to evaluate the quality of the product or service for every contract source selection. See FAR 15.305(a)(3) and 15.308 for specific documentation requirements. In addition, HHSAR 315.305(a)(3)(ii)(A)(1) requires a technical evaluation panel for all acquisitions subject to the HHSAR Subpart 315.3—Source Selection which are expected to exceed \$500,000 and in which technical evaluation is considered a key element in the award decision. Furthermore, standards for internal control provide that internal control and all transactions and other significant events need to be clearly documented and that managers are required to complete all actions that correct or otherwise resolve the matters brought to management’s attention during the course of a review. See also FAR 4.801(b).	4	27	5.4%
7 For cost reimbursement and time and materials contracts (where applicable), are there approved provisional indirect cost rates on file? If so, do the rates claimed on the contractor’s invoice(s) match the approved provisional indirect cost rates?	FAR 42.703-1(b) and 42.704. See also FAR 4.803(c). CMS’s Acquisition Policy Notice 16-01	36	62	40.4%

Appendix I: Scope and Methodology

Internal controls	Criteria/source	Number of errors in the sample	Number of sample items to which the control applied ¹	Estimated lower error limit of all FY 2008 CMS contract actions that did not meet the control test ²
8 If the contract is subject to an annual incurred cost audit of indirect costs, did CMS adjust the contractor's billed indirect rates for final indirect rates?	<p>The government is required to adjust the provisional indirect cost rates used by the contractors for the interim reimbursement of indirect costs based on final indirect rates, which are generally established by auditing the contractor's report of incurred costs (both direct and indirect costs). The FAR requires contractors to submit its report of incurred costs to the government no later than 6 months after the end of its fiscal year. A contract clause prescribed by the FAR commits the government to establishing final indirect cost rates as "promptly as practical" after the receipt of the contractor's report of incurred costs. For purposes of this report, we defined "promptly" as an audit or request for an audit within 12 months of the due date of the contractor's incurred cost report, or a total of 18 months from the end of the contractor's fiscal year end. Twelve months from the due date of the incurred cost report allows sufficient time for the agency to determine the financial resources necessary to perform the audit or pay another agency, such as the Defense Contract Audit Agency (DCAA), to perform the audit.</p> <p>FAR 42.705-2(b)(2) FAR 42.702(b) FAR 52.216-7(d)(2)(i) and (ii)</p>	23	34	52.6%

Internal controls	Criteria/source	Number of errors in the sample	Number of sample items to which the control applied ¹	Estimated lower error limit of all FY 2008 CMS contract actions that did not meet the control test ²
<p>9 If the contract is subject to an annual incurred cost audit of indirect costs, did CMS timely perform or request that the relevant cognizant federal agency perform an audit of direct costs to CMS contracts as part of the incurred cost audit; and were any overbillings recovered?</p>	<p>The audit of direct costs provides agencies with reasonable assurance that the direct costs billed to the government are allowable, reasonable, and allocable to the government contracts. Therefore, direct cost audits are an important control activity to help ensure a proper accountability for stewardship of government resources. In addition, the audit of direct costs is important for the establishment of final indirect rates. In order to establish final indirect rates, the government audits the contractor's allocation bases—which include direct costs—used for calculating and applying the indirect rates. Direct costs are generally audited by the government as part of the audit of the contractor's final indirect rates. For example, DCAA's Information for Contractors Pamphlet, DCAAP 7641.90 (Jan. 2005), § 6-301.b, states that the audit of the contractors' incurred cost proposal includes an evaluation of both direct and indirect costs. As such, for purposes of this report, we evaluated whether CMS requested an audit of direct costs using the same timing criteria for the audit of indirect costs, that is, 18 months from the end of the contractor's fiscal year. Twelve months from the due date of the incurred cost report allows sufficient time for the agency to determine the financial resources necessary to perform the audit or pay another agency, such as DCAA, to perform the audit. See control #8, above.</p>	25	36	54.9%

Appendix I: Scope and Methodology

Internal controls	Criteria/source	Number of errors in the sample	Number of sample items to which the control applied ¹	Estimated lower error limit of all FY 2008 CMS contract actions that did not meet the control test ²
10 Is there sufficient support for the costs claimed on the invoices to enable CMS to sufficiently review the contractor's invoices?	According to FAR 52.216-7(a)(1), the government will make payments to the contractor under cost reimbursement and time and materials contracts in amounts determined to be allowable by the contracting officer in accordance with the contract cost principles and procedures in FAR Subpart 31.2. In addition, FAR states that the government pays contractors under fixed price contracts based on the submission of proper invoices or vouchers (FAR 52.232-1 and 52.232-2). In order to determine whether an invoice is proper or complies with FAR cost principles, contracting officers need to obtain sufficient support that will provide the basis for such determination. According to the Treasury Financial Manual, effective control over disbursements requires a preaudit and approval of vouchers before they are certified for payment (Vol. I, Part 4, §§ 2020.10, 2020.30, and 2025.10). This process will include determining whether the payment and the goods received or services performed were in accordance with the agreement. In addition, standards for internal control provide that "internal control and all transactions and other significant events need to be clearly documented."	53	90	49.9%
11 Is there sufficient evidence that the project officer approved all invoices?	CMS's Acquisition Policy Notice 16-01	61	90	59.0%

Source: GAO.

¹ The specific control we tested may not apply to all items in the sample. For example, the establishment of provisional indirect cost rates is required for cost reimbursement contracts but would not apply to other contract types such as fixed price contracts.

² Based on the results of our work, we are 95 percent confident that the total percentage of contract actions that did not meet the control test is at least the percentage indicated for each control, which is the estimated lower error limit.

To determine the extent to which CMS established a strong control environment for contract management, we interviewed CMS officials and reviewed agency documentation to determine the actions CMS took to address prior recommendations.² We also obtained information from

² GAO, *Centers for Medicare and Medicaid Services: Internal Control Deficiencies Resulted in Millions of Dollars of Questionable Contract Payments*, GAO-08-54 (Washington, D.C.: Nov. 15, 2007), p. 45.

agency officials regarding contract closeout, cognizant federal agency responsibilities, audit funding, and staff resources. We used the internal control standards as a basis for our evaluation of CMS's contract management control environment.

We assessed the reliability of CMS's two acquisition databases, Departmental Contracts Information System (DCIS) and PRISM by (1) performing electronic testing of required data elements, and (2) interviewing both CMS and HHS officials on quality assurance activities performed on the databases. In addition, we used a statistically random sample selected to test the application of controls to also test the accuracy of the data in the systems. We determined that only basic contract information maintained in the PRISM database, such as vendor name and obligation amount, was reliable for purposes of this report. The historical obligation amounts presented in the background section of the report come primarily from CMS's PRISM database.

We requested comments on a draft of this report from HHS and CMS. We received written comments on October 2, 2009, and have summarized those comments in the Agency Comments and Our Evaluation section of this report. Our response to certain specific CMS comments appears in the GAO Comments section of appendix III. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We conducted our audit work in Washington, D.C. and Baltimore, Maryland from July 2008 through September 2009.

Appendix II: Status of Prior Recommendations

GAO recommendation	Progress and GAO evaluation	GAO-determined status
<p>(1) Develop policies and criteria for pre-award contract activities, including (1) appropriate use of competition exemptions such as logical follow-on agreements, unusual and compelling urgency, and the Small Business Administration's (SBA) 8(a) program; (2) analysis to justify contract type selected, as well as, if applicable, verification of the adequacy of the contractor's accounting system prior to the award of a cost reimbursement contract; and (3) consideration of the extent to which work will be subcontracted.</p>	<p>Progress:</p> <p>The Department of Health and Human Services (HHS) reported that (a) the policy and criteria for pre-award contracting activities are already established in the Federal Acquisition Regulation (FAR) and the Health and Human Services Acquisition Regulation (HHSAR), (b) that existing policies would be reviewed and changes would be made as appropriate, and (c) certain pre-award activities, such as the need for adequate accounting systems for cost reimbursement contracts, would be reviewed with staff at internal training sessions.</p> <p>GAO evaluation:</p> <p>While the Office of Acquisition and Grants Management (OAGM) did conduct internal training on various pre-award activity topics, such as the proper circumstances to use sole source contracts, the Centers for Medicare and Medicaid Service's (CMS) actions are unresponsive to the recommendation. OAGM still has not developed policies and criteria that provide clear procedures for staff to follow during the pre-award stage, such as applicable approval levels, time frames, agency forms, and routing processes. Furthermore, while FAR and HHSAR provide regulations agencies must follow, it is up to agency management to develop agency-specific policies and other guidance that implement those regulations.</p>	<p>No action taken.</p>
<p>(2) Develop policies and procedures to help ensure that cognizant federal agency (CFA) responsibilities are performed, including (1) monitoring compliance with the Cost Accounting Standards, (2) a mechanism to track contractors for which CMS is the cognizant federal agency, and (3) coordination efforts with other agencies.</p>	<p>Progress:</p> <p>HHS reported that while HHS is the CFA for CMS's contractors, policies and procedures need to be developed both at the department level and at CMS. Further it stated that to the extent CMS is designated to perform functions supporting HHS as the CFA, CMS will develop appropriate procedures for monitoring Cost Accounting Standards compliance and for coordinating efforts with other agencies.</p> <p>GAO evaluation:</p> <p>Neither HHS nor CMS has developed policies that clearly define key areas of authority and duties for the CFA responsibilities. Moreover, neither HHS nor CMS has developed a list of contractors for which HHS is the CFA.</p>	<p>Actions insufficient. No policies and procedures developed.</p>

Appendix II: Status of Prior Recommendations

GAO recommendation	Progress and GAO evaluation	GAO-determined status
<p>(3) Develop agency-specific policies and procedures for the review of contractor invoices so that key players are aware of their roles and responsibilities, including (1) specific guidance on how to review key invoice elements, (2) methods to document review procedures performed, and (3) consideration to circumstances that may increase risk, such as contract type or complex subcontractor agreements.</p>	<p>Progress: HHS reported that CMS revised its invoice review policy to better define roles and responsibilities.</p> <p>GAO evaluation: We reviewed the CMS revised invoice review policy and determined that new invoice payment procedures contain clear roles and responsibilities.</p>	Completed.
<p>(4) Prepare guidelines to contracting officers on what constitutes sufficient detail to support amounts billed on contractor invoices to facilitate the review process.</p>	<p>Progress: HHS reported that CMS revised its invoice review policy.</p> <p>GAO evaluation: CMS's actions are unresponsive to the recommendation. The revised policy does not specify the documentation the contractors would be required to submit to support the invoices or what would be needed for the project officer, contracting specialist, or contracting officer to validate information in the invoices.</p>	No action taken.
<p>(5) Establish criteria for the use of negative certification in the payment of a contractor's invoices to consider potential risk factors, such as contract type, the adequacy of the contractor's accounting and billing systems, and prior history with the contractor.</p>	<p>Progress: HHS reported that CMS revised its invoice review policy.</p> <p>GAO evaluation: CMS's actions are unresponsive to the recommendation. The revised policy still contains the use of negative certification as a default. This policy does not provide criteria to consider potential risk factors for the use of negative certification in the review of contractor's invoices and discuss circumstances that warrant the use of this method.</p>	No action taken.
<p>(6) Provide training on the invoice review policies and procedures to key personnel responsible executing the invoice review process.</p>	<p>Progress: HHS reported that CMS provided invoice review training to the OAGM staff and project officers on May 7 and May 15, 2008.</p> <p>GAO evaluation: According to the OAGM Internal Training schedule, they provided training on invoice review procedures. However, since CMS has not addressed two of the three recommendations on invoice review—specifically, guidelines to contracting officers on what constitutes sufficient detail to support amounts billed and establishing criteria for the use of negative certification (see above)—actions taken do not achieve the intent of the recommendation.</p>	Actions insufficient. Actions taken do not achieve intent of recommendation.

**Appendix II: Status of Prior
Recommendations**

GAO recommendation	Progress and GAO evaluation	GAO-determined status
(7) Create a centralized tracking mechanism that records the training taken by personnel assigned to contract oversight activities.	<p>Progress: HHS reported that they have implemented the Acquisition Career Management Information System (ACMIS). ACMIS is a centralized tracking mechanism that maintains training records for the personnel assigned to contract activities.</p> <p>GAO evaluation: HHS's implementation of the centralized system to track training addressed our recommendation.</p>	Completed.
(8) Develop a plan to reduce the backlog of contracts awaiting closeout.	<p>Progress: HHS reported that CMS developed a plan to reduce the backlog of contracts overdue awaiting closeout and that CMS reduced this backlog by the end of fiscal year 2007 from 581 to 407 contracts.</p> <p>GAO evaluation: CMS provided its fiscal year 2009 contract closeout plan; however, the plan did not include a comprehensive strategy to reduce the backlog of contracts that are eligible and overdue for closeout. For example, it did not contain a workload analysis, such as a list of contracts eligible for closeout by contracting officer or specialist or an estimate of the number of hours or audit funds it would need to close the contracts. The fiscal year 2009 plan only contained three bullets stating that OAGM would provide quarterly reports to the division directors and training to OAGM staff. It also stated that OAGM would establish "a contract closeout day." Furthermore, as discussed in the body of this report, the backlog of contracts overdue for closeout persists.</p>	Actions insufficient.
(9) Review the questionable payments identified in this report to determine whether CMS should seek reimbursement from contractors.	<p>Progress: HHS reported that CMS will review the questionable payments identified in GAO-08-54 to determine whether CMS should seek reimbursement from the contractors. It further stated that the questionable costs will be identified in the course of incurred cost audits which CMS will obtain in the course of closing out the contracts. Additionally, CMS described specific actions taken to investigate some of the questionable payments.</p> <p>GAO evaluation: The actions taken to investigate questionable payments were either insufficient or incomplete. CMS's approach to delay investigation and recovery to the end of the contract performance period does not result in timely resolution of questionable payments of this magnitude. Audits and inquiries into the issues we identified in our report should be made as soon as possible.</p>	Actions insufficient.

Source: GAO analysis, based on a CMS-provided report (dated December 3, 2008) used by HHS to track the resolution of GAO audit findings, interviews, and other documentation such as agency policies.

Appendix III: Comments from the Centers for Medicare and Medicaid Services

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



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: OCT 2 2009

TO: Andrea Palm
Acting Assistant Secretary for Legislation
Office of the Secretary

FROM: Charlene Frizzera *Charlene Frizzera*
Acting Administrator

SUBJECT: Government Accountability Office Draft Report: "Deficiencies in Contract Management Internal Control are Pervasive" (GAO-10-60)

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) draft report entitled, "Deficiencies in Contract Management Internal Control are Pervasive," (GAO-10-60).

The Centers for Medicare & Medicaid Services (CMS) is committed to the highest degree of integrity in the conduct and management of its contracting activities. Furthermore, CMS seeks to continually improve and strengthen its acquisitions functions. To that end, we appreciate the work that GAO has done to review our contracting activities, and believe that GAO's findings and recommendations will serve as a catalyst for improvements to the internal controls for our contracting functions.

The Federal Acquisition Regulations (FAR) and the Health and Human Services Acquisition Regulations (HHSAR) prescribe literally hundreds of internal controls for Federal Government contracting. In its review, GAO considered only 11 internal controls, some of which have common elements. While we feel that a limited scope review does not provide for a complete picture of the internal controls CMS has established, we are encouraged by the fact that virtually all of those errors relate to perceived documentation deficiencies, and do not involve more substantive departures from the FAR or HHSAR.

We are providing the following responses to GAO's recommendations:

Recommendations from 2007 Audit

We are concerned that GAO, in questioning the implementation of its prior findings, did not consider the timing of the release of its November 2007 report in that it did not permit a reasonable amount of time to elapse to allow for corrective action to be taken. In November 2007, GAO issued a report that identified perceived deficiencies in CMS' acquisition internal controls. Hence, the November 2007 report was issued in fiscal year (FY) 2008. With respect to

See comment 1.

See comment 1.

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the current draft report, GAO considered contract actions that occurred in FY 2008. Accordingly, many of the purported deficiencies in the draft report stem from its review of contract actions that occurred prior to the time it was reasonably possible for CMS to implement the recommendations contained in the November 2007 report. That being said, CMS did, in fact, substantially implement the recommendations contained in GAO's 2007 report. Our responses to GAO's contention that findings remain unresolved from the November 2007 GAO report are as follows:

1. Policies and criteria for preaward contract activities have not been developed.

We disagree. In the November 2007 report, GAO recommended that CMS develop policies for certain pre-award contract activities, such as the analysis required to justify the contract type selected and the measures required to verify the adequacy of a contractor's accounting system prior to the award of a cost reimbursement contract. However, in the draft report GAO states that no new policies or guidance were developed. The finding does not consider actions taken by CMS.

The original recommendation in the November 2007 report arose from a unique situation involving the award of noncompetitive cost-reimbursement contracts required to implement the mandates of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), Pub. L. No. 108-173. In our comments to the November 2007 report, we provided justification for the necessity to award contracts noncompetitively and on other than a fixed-price basis because of the limited time provided by Congress to implement important new health care programs. Also, because the new requirements for the Medicare prescription program were evolving, it required that CMS contract for needed services on a cost-reimbursement basis. Moreover, the MMA itself provided statutory authority for the noncompetitive award of certain contracts necessary to carry out the mandates of this important legislation. Although this particular event required the use of certain types of contracts, we have expressed our commitment to competition and said we would continuously promote the competitive award of contracts through our policies and procedures and would continue to provide appropriate training to our employees.

Since the issuance of the November 2007 GAO report, we have promulgated policies and guidance for preaward contract activities. Specifically, in May 2008, CMS obtained licenses to Acquisition Solution's Virtual Acquisition Office (VAO) for all of the staff of the Office of Acquisition and Grants Management (OAGM). The VAO is a Web-based tool that contains detailed checklists and instructions as well as templates for virtually every type of contracting action. It links acquisition policies and procedures to the relevant sections of the FAR and other applicable authorities. The VAO is widely used throughout the Federal Government. It is intended to provide contracting staff with information needed to achieve consistency in their performance as well as compliance with the FAR. We have provided extensive training on the use of the VAO. Therefore, by adopting the VAO, we have provided our contracting staff with extensive access to policies, guidance, and operational procedures regarding contracting policies and procedures. Moreover, we have provided a great deal of training to our employees

See comment 2.

See comment 3.

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regarding preaward contracting requirements and activities.

2. Roles and responsibilities for implementation of CFA responsibilities not clearly defined.

We agree. In accordance with FAR 42.003, Cognizant Federal Agency (CFA) responsibility normally would fall upon the agency with the largest amount of negotiated contracts with a contractor. For CMS, an Operating Division of the Department of Health and Human Services (DHHS), the Department would be the CFA. HHSAR 342.705 addresses the authority to establish indirect cost rates, fringe benefit rates, etc., for use in contracts and grants awarded to commercial organizations. This section of the HHSAR delegates CFA indirect cost rate responsibilities to the Division of Financial Advisory Services of the National Institutes of Health (NIH). We agree with GAO that we need to establish additional policies and procedures for the performance of CFA functions. We have already started to develop the necessary policies for CMS Contracting Officer performance of CFA functions and will coordinate activities with the Department.

See comment 1.

3. CMS did not always require contractors to submit invoices that contain sufficient information to facilitate an adequate review.

We disagree. We have developed very detailed and complete guidelines for Contracting Officers and Project Officers on what constitutes sufficient detail to support contractor invoices. On May 5, 2008, we issued Acquisition Policy 16-01, entitled "Invoicing Payment Procedures." This policy issuance contained detailed guidance as to precisely what information a Contract Specialist or Contracting Officer needs to consider in reviewing and approving an invoice. Moreover, we have conducted extensive training for both contracting and program staff on the review and approval of invoices. The concerns expressed in the GAO draft report with regard to the approval of contractor invoices are largely attributable to the timing of the latest review, and that sufficient time had not elapsed to fully train staff and to implement the invoicing policies contained in the May 5, 2008, policy directive.

See comment 1.

4. CMS has not set criteria for the use of negative certification.

We disagree. In Acquisition Policy 16-01 we imposed the requirement that a Contracting Officer obtain documentation from the Project Officer that demonstrates the Project Officer's review and approval of an invoice. Contracting Officers are required to sign an invoice as evidence of approval. If a Contracting Officer does not have a complete record supporting the payment of an invoice, he or she must notify the payment office within 20 days of the receipt of the invoice that the payment is disapproved. A copy of the signed invoice is to be placed into the contract file to document the Project Officer's and Contracting Officer's approval.

The draft report found that there were instances where the contract file did not have a copy of an invoice signed by the Project Officer. However, our policy requires that a

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Project Officer sign a “Payments and Progress Certification Form”, as opposed to the actual invoice. We will reexamine our invoicing policies and will make appropriate changes to those policies to assure that there is adequate documentation in the contract file to support both the Project Officer’s and Contracting Officer’s approval of an invoice. We will further provide training to both contracting and program staff on the review and approval of invoices to reemphasize each of their responsibilities in this process.

5. Training on invoice review procedures still needed.

We agree. While we have provided extensive training in the past 2 years to both contracting and program staff regarding the processing and approval of contract invoices, we will continue those efforts and provide further training to CMS staff on the review and approval of invoices.

6. Continuing backlog of contracts for closeout.

We disagree. We have, in fact, developed a contract close out plan that has resulted in over a 30 percent reduction in the number of contracts eligible for closeout since 2007. For FY 2009, we fully expect to be “Green” for the contract closeout element in the DHHS Acquisition Dashboard. We have taken measures to reduce the backlog of open contracts, including dedicating staff to the contract closeout function. We have also secured additional funds to obtain incurred cost audits necessary for contract closeout. We further have contractor support to expedite the contract closeout process.

7. CMS has not taken action to investigate and recover questionable payments.

We disagree. The CMS has taken action to investigate and recover what GAO characterized as questionable payments in its November 2007 report. In that report, GAO asserted that CMS had made \$88.8 million in questionable payments. At that time, we disagreed with the finding in large part because the payments in question were interim payments under cost reimbursement contracts, and Contracting Officers had reasonable bases for approving the questioned payments. We indicated in our response that we would obtain audits of all costs under the contracts at issue and would take appropriate action to recoup any inappropriate contract payments.

At this point, we have taken action to determine the appropriateness of the questioned payments. Specifically, as described in the November 2007 report, most of the alleged questionable costs were incurred under prime contracts and subcontracts with one specific contractor. Those costs amounted to \$67 million. We have obtained incurred cost proposals from the contractor and have been working with the Defense Contract Audit Agency (DCAA) to schedule the required contract audits. The earliest DCAA can schedule the audit of the FY 2008 incurred cost submission is later this fiscal year. The Contracting Officer was vigilant in obtaining incurred cost submissions from the contractor and in pursuing the audit review of the contractor’s costs. For the other contracts for which costs were questioned, we have obtained incurred cost proposals. In

See comment 4.

See comment 1.

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some instances, we completed our consideration of the costs and made appropriate modifications to the contracts to resolve the cost issues. In other instances, audits of the questioned costs have been completed and we are in negotiations to finalize the allowability of costs under the contracts, or we are awaiting DCAA's completion of audits.

Recommendations

The recommendations contained in the current GAO report, together with our responses, are as follows:

The Administrator of CMS should:

- 1. Document compliance with FAR requirements for different contract types. At a minimum, enhance current documentation, such as the contract checklist, to ensure the contract file documents authorizations for letter contracts, adequacy of the contractors accounting systems, and determination and findings for time and materials contracts, when applicable.**

We agree. We have disseminated to CMS contracting staff relatively complete instructions and guidance for contracting actions that are intended to assure compliance with FAR requirements. In so doing, we developed a standard checklist for all CMS contracts which has served as an effective internal control for assuring consistency in CMS contracts and compliance with the FAR and HHSAR. In addition, the Virtual Acquisition Office contains extensive contracting checklists and provides detailed step-by-step instructions for the completion of contract actions. DHHS has developed new contracting checklists which, in accordance with HHSAR 304.803-70, are mandatory for all DHHS contracts as of October 1, 2009. It appears that these new checklists will generally address GAO's concerns. However, we will share GAO's recommendations with the Department so that appropriate revisions can be made to the checklists or other HHSAR provisions to implement those recommendations. We will further review CMS' internal procedures to provide necessary supplemental guidance. We will also provide training to our staff on the use of internal control measures which either the Department or CMS develops.

- 2. Document in the contract file provisional indirect cost rates used as a basis for reviewing the reasonableness of the indirect costs billed on the contractor invoices.**

We agree. GAO identified instances where it does not believe that the contract file contained adequate support for provisional indirect cost rates. We have established a highly-skilled and experienced team of contract auditors who work with CMS' Contracting Officers on all cost-related matters, including the establishment of provisional indirect cost rates. Documentation to support provisional indirect cost rates is maintained by that team in centralized files. Contracting Officers approve provisional indirect cost rates based upon that documentation. Hence, we have established a process that is intended to assure the reasonableness of provisional indirect cost rates. GAO was

See comment 5.

See comment 6.

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concerned that CMS did not retain the supporting documentation for each individual contract file. We agree to strengthen our internal controls by including the supporting documentation in the relevant contract files. We will develop policies for documenting provisional indirect cost rates that will provide an appropriate level of internal control.

- 3. Specify what constitutes timely performance of (or request for) audits of contractors' statements of incurred cost for cost reimbursement and T&M contracts, including circumstances when OAGM should perform the audit itself or request another organization to perform the service.**

We agree that guidance is needed as to what constitutes timely performance of contract audits and which provides more detailed instructions to Contracting Officers regarding the process for obtaining needed audit services.

- 4. Specify circumstances under which negotiation memorandums should be used and the content of such, and any required secondary reviews, in light of HHSAR requirements and current OAGM practice.**

We agree that the preparation of a negotiation memorandum is an important internal control which provides a basis to assess the adequacy and appropriateness of a Contracting Officer's actions in awarding a contract. We will therefore develop guidance on the preparation of negotiation memorandums and we will provide appropriate training to CMS staff.

- 5. Specify Contract Review Board review documentation to include, at a minimum, documentation of the number of contracts reviewed each year; the issues identified by the CRB reviewer(s); and resolution of issues identified during the CRB reviews.**

We agree. The Contract Review Board (CRB) is an internal control that CMS established to promote the appropriate award of CMS contracts and compliance with the FAR and HHSAR. We believe that it is an important internal control. We will therefore reexamine our CRB policy and make appropriate revisions to ensure that eligible contracts are reviewed to the maximum practicable extent and that CRB findings are fully resolved.

- 6. Require Division Directors to periodically assess, document and report to senior management on the results of their review of whether the contract files contain documentation that invoices were properly reviewed by both the project officer and contracting officer or specialist.**

We agree. The OAGM Division Directors are responsible for assuring that staff performs contract actions in compliance with the FAR and HHSAR and that all contract actions are adequately documented. We will establish a reporting mechanism whereby Division Directors will have a means to document that invoices are properly reviewed and file documentation is otherwise complete and adequate.

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OAGM Management

- 1. Develop and implement a comprehensive strategic acquisition workforce plan. The plan should include, at a minimum, elements such as performance goals, time frames, implementation actions, and resource requirements and address issues such as OAGM workload, full time equivalents needed, and a workforce skills analysis; as well as an estimate of the amount of resources OAGM needs to fulfill the audit and other FAR requirements for comprehensive oversight, including those required of a CFA.**

We agree. We have performed various assessments of CMS' acquisition workforce in the past, especially when necessary to determine staffing resources required to implement major new contracting initiatives such as the competitive award of contracts to Medicare Administrative Contractors. The Agency has added additional resources to the acquisition workforce based upon those assessments. We concur that there would be benefits to undertaking a broader and more strategic analysis of the acquisition workforce and to developing an acquisition workforce plan.

- 2. Revise the Verification and Validation Plan for DCIS Accuracy and Improvements policy to require all relevant errors be corrected and their resolution documented.**

We agree. The draft report states that there were numerous errors in the data entered into the Departmental Contracts Information System (DCIS). In FY 2008, we initiated a number of actions to facilitate the accuracy of data entered into DCIS. Since GAO's review occurred in FY 2008, when those measures were in the process of being implemented, they were not reflected in this report. We are committed to ensuring the accuracy of all data entered into our procurement systems. We expended a great deal of effort to develop policies and procedures that were intended to ensure the accuracy of data entry. We conducted extensive training for all OAGM personnel on data entry. As part of that training, we developed very specific guides that clearly identified the information to be entered into DCIS fields. CMS' policies and processes were adopted by DHHS as the model that all Operating Divisions were required to employ. On November 26, 2008, DHHS issued Acquisition Policy Memorandum 2008-05, which implemented the CMS plan for the entire Department. These instructions were issued after the close of FY 2008, the period that was the subject of GAO's review.

Since FY 2008, we have sought to improve our data entry accuracy as our policies and procedures evolved and we have provided additional training and guidance to our employees. A sample of DCIS entries reviewed in FY 2009 was determined to have an accuracy rate of 98 percent. Moreover, we have implemented a process whereby if an error is found in a DCIS entry, the DCIS reviewer provides a scorecard to the Contract Specialist and their manager. The Contract Specialist is required to notify the DCIS reviewer when the error has been corrected. Hence, there is a process for documenting the resolution of DCIS issues. We will review our policies and procedures and make improvements as necessary.

See comment 7.

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- 3. Develop and implement policies and procedures for tracking contract audit requests, monitoring the results of contract audits and evaluations, and resolving the audit findings, to include roles and responsibilities of the contracting officer, specialist, and members of the cost/price team.**

We agree that improvements are needed to our policies and procedures for tracking contract audit requests and for monitoring the results of those audits and the subsequent resolution of those findings. We will make appropriate revisions to our policies and procedures to better manage the audit process.

Secretary of HHS

Develop policies and procedures that clearly assign roles and responsibilities for the timely fulfillment of CFA duties, and that include the preparation of and periodic update of a list of contractors for which the department is the CFA.

We agree. We will work with the Department to clearly distinguish among the different types of CFA duties, including contract audit (Office of Inspector General); commercial indirect rates (NIH); non-profit indirect cost rates (PSC), etc. Regarding the contract audit function, DHHS plans to issue a joint Office of Inspector General /Office of Acquisition Management and Policy memorandum.

GAO Comments

1. See “Agency Comments and Our Evaluation” section.

2. As we stated in our November 2007 report¹, we acknowledge that the time frames for implementing the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 added schedule pressures for the Centers for Medicare and Medicaid Services (CMS). At the same time, the compressed time frames and resulting contracting practices added risk to the contracting process. Many of the findings in the November 2007 report were a result of the increased risk together with inadequate compensating controls to mitigate risk.

3. While the Virtual Acquisition Office, which is an off-the-shelf acquisition software that provides Web links to acquisition regulation and templates to aid in completion of common acquisition activities, can be a useful tool for contracting officers, specialists, and the Office of Acquisition and Grants Management (OAGM) management, it does not represent the agency-specific policies and criteria we recommended that CMS implement for pre-award activities. As such, CMS’s actions are unresponsive to the recommendation. Agency-specific policies provide guidance on how CMS staff are expected to perform their day-to-day duties.

4. As discussed in the report, we continue to believe the contract closeout plan does not sufficiently address our recommendation because it did not include a comprehensive strategy to reduce the backlog of contracts that are eligible and overdue for closeout, nor did it contain a workload analysis. The plan was for fiscal year 2009; no other plans were developed. Additionally, CMS stated that it achieved a 30 percent reduction in the number of contracts eligible for closeout since 2007. However, CMS could not fully support the analysis it provided and it related only to the time period between April 2007 and September 30, 2007.² According to data provided to us by CMS during this current review, since September 30, 2007, the number of contracts eligible for closeout has increased by 24 percent, from 1,300 in 2007 to 1,611 in 2009. Additionally, the number of contracts overdue for closeout has increased from 407 in 2007 to 594 in 2009, a 46 percent increase.

¹ GAO, *Centers for Medicare and Medicaid Services: Internal Control Deficiencies Resulted in Millions of Dollars of Questionable Contract Payments*, [GAO-08-54](#) (Washington, D.C.: Nov. 15, 2007).

² The number of contracts eligible for closeout and overdue for closeout as of September 30, 2007, was reported in our November 2007 report.

5. The contract file document checklist employed by CMS at the time of our review identified key documents that may be included in a contract file. This checklist is usually completed by either the contract specialist or contracting officer. While such a checklist is useful for ensuring that certain documents are contained in a contract file, it did not reflect certain requirements in which we found CMS to be deficient, such as ensuring contractors had adequate accounting systems prior to the use of a cost reimbursement contract. We are encouraged that CMS is taking additional actions to implement the checklists developed by the Department of Health and Human Services to be used in fiscal year 2010.

6. During our review and as a result of multiple conversations with OAGM staff including the team of contract auditors, we revised our testing procedures to consider and accept provisional indirect cost rates that were not maintained in the individual contract file but were maintained by the cost/price team in its central files. Therefore, all provisional indirect cost rate determinations that were maintained by OAGM, regardless of location, were considered during our review. The steps CMS described that it plans to take will be important for ensuring that contract office staff have the information needed readily available to manage contracts throughout the contract life cycle.

7. As stated in the report, CMS's current procedures regarding the accuracy of data entered into the Departmental Contracts Information System (DCIS) do not include procedures that would ensure that the resolution of potential errors are properly documented and errors are corrected in a timely manner. We further found that OAGM was not fully implementing its policy because it reviewed every 88th action, rather than every 50th as provided for in the plan. However, we are encouraged by the recent initiatives described in CMS's comments, such as the scorecard, and OAGM's commitment to review current policies and procedures and to make improvements where necessary.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Kay L. Daly, (202) 512-9095, or dalykl@gao.gov

Acknowledgments

Staff members who made key contributions to this report include Marcia Carlsen and Phil McIntyre (Assistant Directors), Sharon Byrd, Richard Cambosos, Abe Dymond, Patrick Frey, Jason Kelly, John Lopez, Ron Schwenn, Omar Torres, Ruth Walk, and Danietta Williams.

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