

October 1992

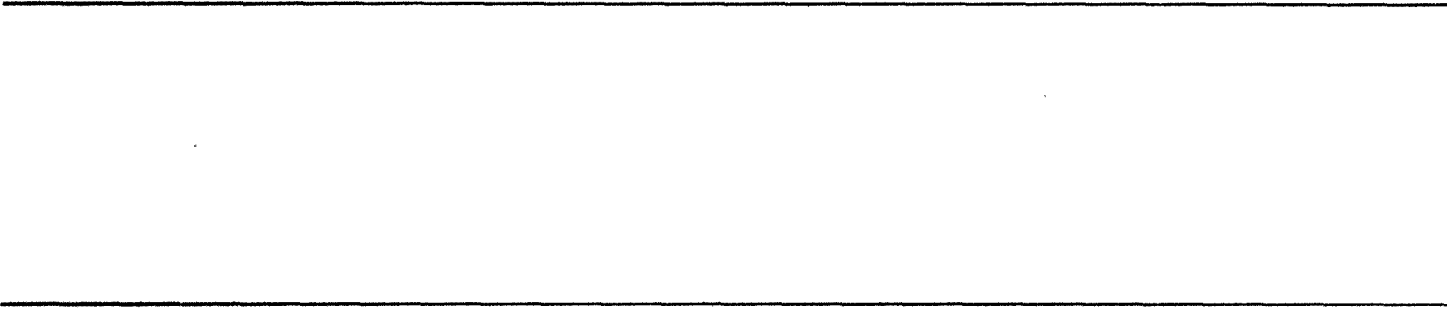
JOHNSON SPACE
CENTER
PROCUREMENT

Controls Over
Payments to
Contractors Should Be
Strengthened



147779





**Information Management and
Technology Division**

B-249741

October 23, 1992

**The Honorable Daniel S. Goldin
Administrator, National Aeronautics
and Space Administration**

Dear Mr. Goldin:

In January 1990 we began a special initiative to help identify areas within government that were potentially vulnerable to waste, abuse, and mismanagement. Contract management practices of the National Aeronautics and Space Administration (NASA) was one of 16 areas that GAO identified as high-risk. We selected NASA because it (1) spends about 90 percent of its annual appropriations on contracts, and (2) consistently reports significant internal control weaknesses in contracting and procurement areas in its annual Federal Managers' Financial Integrity Act reports.

The objective of this work was to determine if the Lyndon B. Johnson Space Center (JSC) in Houston, Texas, had adequate internal controls over the management of information processing contracts, grants, and purchase orders. We selected three cost-plus-award-fee contracts with significant information processing requirements for our review because they are, according to NASA procurement representatives, among the most complex to manage, and have end products that are usually unique and sometimes difficult to objectively measure and evaluate. At JSC we selected and reviewed the management controls over these three contracts, currently valued at more than \$425 million. Details of our objectives, scope, and methodology are provided in appendix I.

Results in Brief

Although JSC has various systems of internal controls in place, those used for paying contractors make JSC vulnerable to potential waste, abuse, and mismanagement. Specifically, JSC contracting officers and technical representatives do not link the receipt of products and services actually received against the cost vouchers contractors submit for payment. While JSC relies on a series of internal control mechanisms for assurances that contractors deliver high quality goods and services, none of these mechanisms is a sufficient substitute for periodic linking of contractors' cost vouchers with products actually received. As a result, opportunities exist for JSC to be billed—and pay—for goods and services never received.

Background

During fiscal year 1991, NASA awarded more than \$13 billion in contracts to accomplish assigned missions of operating the nation's space flight programs, conducting scientific research, and developing and supporting new commercial initiatives. The success of these missions is highly dependent on the success of private contractors' completing information technology projects as diverse as integration of computer hardware and software systems for space shuttle missions to managing the acquisition and operations of institutional information processing equipment. JSC is NASA's largest manager of information processing-related contracts and grants. During fiscal year 1991, more than \$2.8 billion was disbursed on contracts and grants issued by JSC. About 25 of these—valued at more than \$279 million—included contracts whose principal products are primarily resources and services covered under the Federal Information Resources Management Regulations.

JSC relies on a system of internal controls for managing its contracts. Among others, these controls include the significant role of people—contract monitors (contracting officers, contracting officer technical representatives, and others) and internal and external audit groups responsible for monitoring or managing specific aspects of NASA contracts. All must be operating together effectively to ensure that NASA obtains the quantity and quality of goods and services ordered, and pays only for what it has actually received.

JSC Pays Contractor Vouchers Without Linking to Products

The Office of Management and Budget, Department of the Treasury, and GAO have established minimum standards that must be met by all financial systems in the federal government. Sound internal controls—a component of this guidance—help ensure that the quantity and quality of goods and services approved for purchase are consistent with the products actually delivered and billed. However, JSC is remiss in this area. Specifically, since March 1989 JSC paid more than \$120 million for specific products under the three contracts reviewed, without linking the delivery of these products against the contractors' vouchers. While JSC management directives require technical users (the end recipients of contractor services) to ensure that projects, systems, or subsystems meet predetermined requirements including budget, time frames, and technical quality, the directives do not specifically require users to verify that contractors have actually provided the goods and services billed before authorizing payments to contractors.

We interviewed contracting officers and their respective technical representatives about the specific responsibilities and steps they took to verify that contractors delivered goods and services to JSC before payment was made. Neither the contracting officers nor their representatives actually verified that contractors delivered goods and services as required. They said that they relied on the Defense Contract Audit Agency (DCAA) for this assurance.¹ Officials of JSC's Financial Management Division, the organization responsible for paying contractors, said that they likewise rely on DCAA for assurances that contractors' cost vouchers are adequately reviewed and approved for payment. Once the division receives a voucher approved for payment by DCAA, it immediately authorizes payment to the contractor.

DCAA Approves Cost Vouchers for Payment

DCAA reviews and approves cost vouchers submitted for payment but is not required to link vouchers to actual receipt of goods and services. Contractors develop and submit cost vouchers about twice a month, on the basis of costs incurred for specific periods, as recorded in the contractor's accounting records. The contractor submits cost vouchers directly to DCAA for review and provisional approval.² DCAA's audit policies require cost vouchers to be reviewed and either approved for payment or returned to the contractor for correction as quickly as possible, but not later than 5 working days after receipt. One DCAA auditor said that he tries to approve a contractor cost voucher on the same day he receives it.

Because of the relatively short time for review—5 days or fewer—DCAA on-site auditors rarely, if ever, have access to or examine contractors' full accounting records in connection with their approval of the vouchers. Instead, DCAA reviews cost vouchers for accuracy of arithmetic; overhead rates; and general and administrative rates, cost schedule and budget estimates, and reconciliation with previous vouchers. If these checks appear correct, the auditor approves the voucher for provisional payment, subject to later and final audit, and sends it to JSC's Financial Management Division for payment.

¹Individual NASA centers do not normally contract directly with DCAA. Under a master contract with NASA headquarters, DCAA performs a variety of services for individual centers, including JSC. Individual centers then enter into agreements with DCAA to perform specific services necessary to meet their needs. These services include audits of cost proposals, incurred cost audits after contracts have been completed, floor checks, defective pricing audits, and cost accounting standards audits.

²A provisional approval is a pay-now-and-audit-later policy that essentially gives the government certain rights to correct billing or payment errors if they are found later.

This is not to imply that DCAA auditors do not find errors or discrepancies. In one instance DCAA auditors found that a contractor's billed overhead rate was 122 percent of the normal overhead rate, due to an accounting error. In another instance, DCAA auditors found that a contractor accrued material costs before actually receiving materials, and wrongfully billed the government for estimated subcontractor costs. DCAA auditors believe they have a chance to detect and correct instances of unsupported, unreasonable, or unallowable costs claimed by contractors during incurred cost audits, audits they sometimes perform—due to backlogs in their work—several years after actual contract performance has ended.

JSC Procurement Officials See Controls as Adequate

JSC procurement officials believe that their current management controls are adequate and do not believe that linking receipts of goods and services with contractors' cost vouchers is necessary or practical. They stated that (1) cost-reimbursement contracts do not require the delivery of discrete products as a condition for payment, and that (2) requiring a NASA representative's approval of each voucher before payment would result in increased processing times, administrative burden, lost discounts, and late payments.

JSC officials believe that controls and processes in place for managing cost-plus-award-fee contracts—contracting officers, technical representatives, financial analysts, DCAA, and others to review and approve contractor vouchers, and to accept goods and services—serve as adequate checks and balances and provide JSC with sufficient assurances that contractors perform as expected. Examples they cited include

- reviews of monthly financial management reports,
- periodic technical and resource status reviews, and
- the performance evaluation process for cost-plus-award-fee contracts.

However, the chief of JSC's Procurement Support Division agreed that JSC contract monitors, in all probability, could not prevent and might not be able to detect instances in which persons decided to commit fraudulent acts.

Federal Standards Require Matching Vouchers With Products

In January 1988, the Office of Management And Budget, Department of the Treasury, and GAO established minimum standards that must be met by all financial systems in the federal government.³ As part of the requirement to properly record, track, and control payments to others, agencies must match requisitions, purchase orders, receiving and authorization documents, and invoices. Specifically, agencies are required to establish a three-way matching process between purchase order, receiving report, and invoice. In December 1989 the Office of Management and Budget prescribed policies and procedures for paying for property and services acquired under federal contracts, with particular reference to implementing the Prompt Payment Act of 1982 (31 U.S.C. 39).⁴ The circular states that agencies are responsible for assuring that effective internal control systems are established and maintained while ensuring that receipt and acceptance of goods and services are executed as promptly as possible.

Conclusions

JSC's existing controls, while sufficient for monitoring contractor performance, are not a substitute for sound financial management practices. While we agree that JSC must continue to be prompt in paying contractors, this should not preclude JSC from establishing practicable controls to reduce the risk of being billed—and paying for—goods and services ordered but never received. Such controls are required in the federal standards established for financial systems. Given the size of NASA's annual contract expenditures, complexity of NASA projects, and reported internal control weaknesses, none of the steps we reviewed are a sufficient substitute for assurances provided by the periodic linking of contractors cost vouchers with products received. To provide stronger assurances that JSC is getting what it pays for and only paying for what it has received, NASA personnel with first-hand knowledge of actual performance and delivery must be involved in the review and approval loop for contractors' vouchers—even if done on a prescribed and approved sampling basis and performed subsequent to actual payment.

³Core Financial System Requirements, Joint Financial Management Improvement Program, Jan. 12, 1988.

⁴Prompt Payment, OMB Circular A-125 (revised), Office of Management and Budget, Dec. 12, 1989.

**Recommendation to
the Administrator,
National Aeronautics
and Space
Administration**

To provide better assurance that controls are sufficient to prevent waste, abuse, and mismanagement, we recommend that you require JSC to systematically assess its internal control system for payments made under cost-reimbursement contracts, and develop appropriate procedures to link payments to contractors with acceptance of goods and services actually ordered and delivered.

This report contains a recommendation to you. As you know, the head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

We discussed the contents of this report with senior procurement officials in Washington and at JSC, including the directors of the Procurement Management and Procurement Policy Divisions, Office of Procurement; and the assistant to the director, Mission Operations Directorate. We incorporated their comments where appropriate. As stated above, JSC officials believe that their current controls are adequate and do not believe that linking receipts of goods and services with contractors' cost vouchers is necessary.

We performed our audit work in accordance with generally accepted government auditing standards, between September 1991 and August 1992. Copies of this report are also being sent to appropriate congressional committees and will be made available to others upon request.

This report was prepared under the direction of Samuel W. Bowlin, Director, Defense and Security Information Systems, who can be reached at (202) 512-6240. Other major contributors are listed in appendix II.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Ralph V. Carlone". The signature is fluid and cursive, with the first name "Ralph" being the most prominent.

Ralph V. Carlone
Assistant Comptroller General

Objectives, Scope, and Methodology

We initiated a broad survey to determine if JSC had adequate oversight and sufficient internal controls over information processing contracts, grants, and purchase orders. We selected three contracts (all are cost-plus-award-fee, with two being level-of-effort contracts), which involved the acquisition of significant federal information processing resources, because they are among the most difficult to manage, with end products that are usually unique and involve many intangibles. We selected JSC because it spends more on information processing than any other NASA center.

We first selected and examined JSC's practices for monitoring information processing contracts to determine the most vulnerable areas. We identified and validated with JSC management the presence and importance of JSC's key controls, including

- contract monitors (contracting officers, contracting officer technical representatives, and others) responsible for monitoring or managing specific aspects of NASA contracts;
- automated information systems that keep track of financial and other information related to contracts;
- internal and external audit groups that periodically review certain aspects of contract management;
- periodic evaluations and the use of award fees to regulate contractor performance; and
- a standards-of-ethical-conduct program that is intended to provide NASA with assurances that the public can maintain confidence in its employees and the agency's integrity.

We then tested for the presence of these controls during several phases of contract award and management, including contracts and grants awards, contractors' performance evaluations, performance fee awards, and disposal of resources.

We then focused our objectives on (1) identifying and assessing weaknesses in NASA's mechanisms for managing contracts, (2) identifying the causes of these weaknesses, and (3) determining appropriate actions NASA can take to improve contract management activities. To do this we

- interviewed NASA and JSC procurement, program, legal, and financial management officials responsible for day-to-day management of selected contracts and for overall contract management;

- examined NASA and JSC's policies and documents governing contract management;
- selected and reviewed three active information processing contracts that JSC officials believe were representative of their overall managerial efforts;
- reviewed and tested JSC's management of its standards-of-ethical-conduct and outside employment programs (we closely examined program documents submitted by the 114 contract monitors responsible for managing selected contracts at JSC); and
- interviewed officials in NASA's Office of Inspector General, DCAA, and Defense Contract Management Command, regarding their roles in supporting JSC.

Our audit work was performed at NASA headquarters in Washington, D.C., and JSC in Houston, Texas.

Major Contributors to This Report

Information
Management and
Technology Division,
Washington, D.C.

James R. Watts, Associate Director
Ronald W. Beers, Assistant Director

Dallas Regional Office

William H. Thompson, Evaluator-in-Charge
Roy Buchanan, Staff Evaluator
Leticia C. Villarreal, Staff Evaluator

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

**U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877**

Orders may also be placed by calling (202) 275-6241.

**United States
General Accounting Office
Washington, D.C. 20548**

**Official Business
Penalty for Private Use \$300**

<p>First-Class Mail Postage & Fees Paid GAO Permit No. G100</p>
--