

GAO

United States General Accounting Office

Report to the Chairman, Subcommittee
on Oversight of Government
Management, Senate Committee on
Governmental Affairs

January 1992

AD-A244 702



**DEFENSE
CONTRACTING**

Key Data Not
Routinely Used in
Progress Payment
Reviews

92-01866



National Security and
International Affairs Division

B-244459

January 14, 1992

The Honorable Carl M. Levin
Chairman, Subcommittee on Oversight
of Government Management
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

Congress recently expressed concern about excessive progress payments made by the Department of the Navy to contractors associated with the A-12 (an advanced attack aircraft) program. To determine whether Department of Defense (DOD) procedures for reviewing contractors' requests for progress payments are adequate, you requested that we examine the handling of these requests in a selected number of major weapon acquisition programs.

Background

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Progress payments are a method of interim contract financing on fixed-price contracts in which the government and the contractor share the financial burden of contract performance. The Federal Acquisition Regulation contains provisions that govern the authorization, administration, and limitations of progress payments. These regulations provide that progress payments are to be made based on the costs incurred and require that progress payments be reduced or suspended when the estimated costs to complete the contract are likely to exceed the negotiated contract ceiling price or when the contractor fails to meet contract performance or schedule requirements. They also limit the amount of payments based on the fair value of undelivered work. Contractors may submit requests for progress payments monthly and are reimbursed at a rate between 75 and 100 percent of costs incurred, depending upon the terms of the contract.¹

With respect to the A-12 program, reports issued by the Navy and other DOD activities indicated that the contractors had significantly understated their estimated cost to complete the work and had not disclosed the existence of a cost overrun, which would have resulted in a reduction of progress payments. These reports also disclosed that government procedures for reviewing progress payments were not followed. They

¹A customary progress payment rate (for large businesses) of 75 percent was in effect for contracts awarded between October 1986 and October 1988. The rate was raised to 80 percent for the period October 1988 through June 1991, and to 85 percent as of July 1991.

showed that the government generally had relied on contractor-generated estimates of completion costs rather than on an independent analysis of contractor performance data or on an assessment of the contractor's actual physical progress.

The Defense Logistics Agency's Defense Contract Management Command is responsible for administering contracts awarded by various DOD organizations and for ensuring that contractors meet their contractual obligations.² The Defense Plant Representative Offices (DPRO) under the Defense Contract Management Command provide on-site surveillance at contractor plants. The DPROs' responsibilities include contract administration, quality assurance, evaluation of contractor cost and performance measurement systems, and production surveillance and reporting. Within each DPRO, the administrative contracting officer (ACO) has the primary responsibility for contract administration, which includes the review and approval of progress payments.

Results in Brief

The ACOS administering various contracts that we reviewed had not been routinely using the most timely indications to identify cost overruns, and thus were not in the best position to prevent overpayments. As a result of problems with the A-12 program, the Defense Contract Management Command recently issued guidance requiring the DPROs to use this information in quarterly program assessments and in annual progress payment reviews, but not as part of monthly reviews of progress payments.

Cost and Performance Data Not Used to Approve Progress Payments

Our review of selected contracts showed that, similar to the circumstances resulting in the A-12 overpayments, ACOS were not routinely using available cost and performance data, such as the DPROs' independent estimated completion costs and production status reports, in their monthly reviews of contractors' progress payment requests. The Navy report on the A-12 program found that the failure to use such data was one of the causes of excessive progress payments.³

²The Defense Contract Management Command was established on February 6, 1990, to streamline contract management procedures. Previously, these functions were carried out by the military services and Defense Logistics Agency activities.

³A-12 Administrative Inquiry, Department of the Navy (Nov. 28, 1990).

To prevent overpayment, contractors' submissions of costs incurred and estimated costs to complete the contract need to be accurate. DOD regulations require contractors to provide data as a basis for responsible decision-making by DOD components. We were told that ACOS' reviews of contractors' monthly progress payment requests were often limited to verifying the progress payment rate, contract price, and mathematical accuracy.⁴

ACOS' reviews are not required to use (1) reports generated by the contractors' cost/schedule control systems⁵ or (2) the DPROs' independent estimates of completion costs, which incorporate their assessments of production and delivery data. Because this information was not routinely used in reviewing monthly progress payment requests, ACOS were not ensuring that the government was provided with the most timely indicators of potential cost overruns.

DPRO technical specialists told us that they generally prepared monthly analyses of weapon programs based on (1) reports generated from contractors' cost/schedule control systems and (2) their routine on-site physical surveillance of contractors' operations. These reports include data on budgeted, actual, and estimated completion costs and include cost trends and schedule and performance status. The reports can serve as a management tool for control and oversight to ensure that the objectives of the program will be met.

ACOS told us that, in conducting their monthly reviews, they might have discussions with the DPRO technical specialists. One ACO used information from these discussions as a basis for withholding a percentage of progress payments on two contracts because of the contractors' inability to meet the delivery schedule. However, the ACOS did not regularly ask technical specialists to furnish their monthly reports in conjunction with the review and approval of progress payments. According to the Navy's report, if the government had used this type of information sooner in

⁴Some DPROs have local computer systems for making these checks. However, the Defense Contract Management Command recently instituted a standardized automated system for reviewing progress payment submissions that will be used at all DPROs.

⁵DOD requires contractors to establish cost/schedule management information systems for selected contracts and subcontracts within programs designated as major acquisition programs. These acquisitions governed by this requirement have a total value of research and development which exceeds \$60 million and production which exceeds \$250 million in constant fiscal year 1990 dollars. Firm fixed-price and firm fixed-price with economic price adjustments are excluded. Application of the cost/schedule management information systems to major construction projects is also encouraged where appropriate.

reviewing the progress payments on the A-12 program, overpayment would not have occurred.

DPRO analyses of estimated completion costs could be used to validate the contractor's estimates to complete the contract and determine if a loss ratio should be applied. A loss ratio is to be applied to the progress payment amount when total contract costs are expected to exceed the negotiated contract ceiling price. When this condition occurs, the amount of costs eligible for monthly progress payments should be reduced based on the ratio of the negotiated contract price to the estimated contract costs at completion. If a loss ratio is not applied as soon as the loss is projected, then an overpayment will probably occur.

Our review disclosed that one contractor had applied a loss ratio, resulting in a reduction in progress payments. Although this action indicated performance problems on the contract, the ACO told us that cost and performance data was not routinely reviewed as part of the monthly progress payment review.

ACOs are to initiate in-depth progress payment reviews at least annually to ensure the reliability and accuracy of the contractors' submissions. These reviews generally include Defense Contract Audit Agency verification of incurred costs and estimated completion costs to the contractor's supporting data and may include the DPRO's technical assessments of the physical progress made on the contract.

At one location, Defense Contract Audit Agency officials cited problems with the contractor's methodology for calculating estimated completion costs on progress payment requests. As a result, the contractor corrected its estimating methodology for major contracts over \$10 million and is in the process of taking corrective action for other contracts. At this location, the DPRO technical specialist's monthly reports could have been used to assess the accuracy of monthly progress payment requests in addition to the Audit Agency's annual review, thereby reducing the risk of overpayment.

Our review showed that the procedures followed by ACOs for reviewing progress payments were similar to the procedures on the A-12 contract. We discussed this situation with DOD officials, and they agreed that the process could be strengthened by better using the DPRO technical specialist monthly reports in reviewing and approving progress payments.

Doing so, they agreed, would provide timely indicators of potential overruns, thereby reducing the risk of overpayment as occurred on the A-12 program.

See appendix I for specific progress payment review procedures and actions taken by ACOS.

Recent Guidance Intended to Improve Surveillance Practices

Since January 1991, when the Navy canceled the A-12 contract for default, the Defense Contract Management Command and the Defense Contract Audit Agency have attempted to improve the government's progress payment surveillance procedures. For example, Defense Contract Management Command instructions now require DPROS to make independent assessments and certifications of estimated completion costs and contractor performance in quarterly reports to the Defense Logistics Agency for Defense Acquisition Board and Service Acquisition Executive programs.⁶

Further, new surveillance guidance issued by DOD now requires DPROS to periodically review progress payment requests using (1) production and delivery data and (2) Defense Contract Audit Agency audits of incurred and estimated completion costs. DPROS' reviews are required annually or more frequently on individual contracts for programs managed by the Defense Acquisition Board or Service Acquisition Executive. For other contracts where the contractor is deemed financially sound, only annual reviews based on a sample of progress payments are required.

This guidance is expected to improve surveillance practices, but it does not provide for the use of available cost and performance data in monthly progress payment reviews. Defense Logistics Agency and cognizant DOD officials generally acknowledged that the use of cost, performance, and production data would strengthen these reviews. However, they added that before requiring the use of this data on all contracts, an evaluation of the administrative burden on ACOS created by this requirement would have to be made.

In addition to the new DOD guidance, the Defense Contract Audit Agency has issued audit guidance intended to improve the progress payment surveillance procedures. The guidance adds audit steps to evaluate a

⁶These major acquisition programs are based on established dollar thresholds for research and development and procurement. Decision-making authority for advancement to each phase (milestone) of these programs rests with the Defense Acquisition Board or Service Acquisition Executive.

contractor's estimated costs to complete a contract using trend analysis techniques for contracts subject to cost/schedule control system requirements. The guidance emphasizes the risk of a contractor overstating the request for progress payments when a contractor is experiencing performance problems.

The Defense Contract Audit Agency has indicated that the more comprehensive progress payments audits will be scheduled according to "risk evaluations." However, the agency guidance does not explain how risk evaluations will be conducted. The agency believes that these evaluations will be a key component in ensuring that progress payments are appropriate and accurate.

Recommendation

To have reasonable and prompt assurances that progress payments are appropriate and accurate, we recommend that the Secretary of Defense require that (1) ACOS be provided with DPRO technical reports generated by the contractors' cost/schedule control systems, DPRO independent estimated completion costs, and production and delivery data and (2) ACOS use this data to identify contracts with performance problems as a basis to conduct detailed reviews of progress payment requests.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD agreed with our findings and agreed that ACOS should be provided with DPRO technical analyses, along with other production management and on-site physical surveillance data as this information relates to the review and approval of progress payments. However, DOD stated that because DPROs use an automated system to review progress payments, the data should be used only when it indicates "a negative performance trend." DOD indicated that manual reviews of progress payments for large contracts would be administratively expensive and divert attention from the contracts that require greater surveillance. DOD added that it would revise its contract administration manuals and establish procedures to identify contracts that could require action by ACOS.

We agree that detailed reviews of progress payment requests should be limited to those contracts for which the production and other data indicate performance problems, and we have revised our recommendation accordingly. However, to have reasonable and prompt assurances that monthly progress payments are appropriate and accurate, ACOS should be required to use the available DPRO technical reports generated by the contractors' cost/schedule control systems, DPRO independent estimated

completion costs, and production and delivery data to identify contracts with performance problems as a basis to conduct detailed reviews of progress payment requests.

DOD's comments are reprinted in their entirety, along with our evaluation of them, in appendix II.

Scope and Methodology

We reviewed progress payment procedures at four DPROs and made a limited review of selected progress payment submissions related to seven contracts and four defense weapons systems. The programs and contracts we reviewed are listed in appendix I. We selected programs and contracts having potential cost or performance problems as indicated in DOD's Selected Acquisition Reports. The DPROs we visited were located at International Business Machines, Manassas, Virginia; General Electric Aerospace, Valley Forge, Pennsylvania; Raytheon, Burlington, Massachusetts; and Grumman, Bethpage, New York.

We discussed procedures for reviewing progress payment requests with ACOS and their staffs, production specialists, cost/schedule control system monitors, and other contract administration and technical staff. We reviewed such reports as a Navy administrative inquiry and a DOD Inspector General report which addressed government practices for the administration of progress payments on the A-12 program. We also reviewed Defense Contract Management Command policies and procedures applicable to DPRO reviews of contractors' progress payment requests and cost and performance data.

We selected four to eight contractor progress payment requests for each contract. For contracts subject to cost/schedule control system reporting, we compared on a limited basis the estimated completion costs with cost/schedule control system data, independent DPRO estimated completion cost analyses, and production reports when available. Our comparison was intended to determine whether any adjustment to progress payments was required. For contracts not subject to cost/schedule control system reporting, we compared the estimated completion costs with the contract price and related production and delivery information. We did not perform a detailed verification of progress payment cost data with supporting contractor cost accounting records.

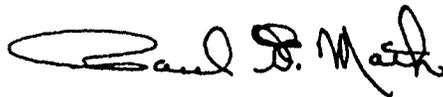
We reviewed Defense Contract Audit Agency reports and discussed the reliability of the contractor's accounting and reporting systems with selected resident auditors. We discussed the results of our review with

DPRO, Defense Logistics Agency, and other DOD officials responsible for progress payment administration.

We conducted our review from January to September 1991 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of Defense; other interested congressional committees; and the Director, Office of Management and Budget. We will make copies available to others upon request. Please contact me at (202) 275-8400 if you or your staff have any questions concerning this report.

Sincerely yours,



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

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Table I.1: Contracts Reviewed and Actions Taken to
Adjust Progress Payments

Abbreviations

ACO	administrative contracting officer
DOD	Department of Defense
DPRO	Defense Plant Representative Office
GAO	General Accounting Office

Actions Taken by ACOs to Adjust Progress Payments

ACOs review the contractors' monthly progress payment requests primarily to ensure that the amounts do not exceed the Federal Acquisition Regulation limitations. These checks are based on contractor data and include the fair value and the loss ratio tests. The fair value test is intended to ensure that progress payments for work in process do not exceed the value of that work. The loss ratio test is intended to preclude premature payment by reducing progress payment amounts when the costs incurred plus the estimated completion costs are expected to exceed the contract ceiling price.

Another purpose of the progress payment review is to determine whether the liquidation rate needs to be changed. Progress payments are partial payments for the future delivery of items. When the items are delivered and accepted by the government, progress payments are liquidated—that is, offset against the invoice price. Generally, the liquidation rate is the same as the progress payment rate. However, if the costs of delivered items exceed the negotiated price, the amount to be liquidated needs to be adjusted to prevent an overpayment.

Table I.1 summarizes ACO adjustments to the selected contracts and progress payment requests included in our review.

**Appendix I
Actions Taken by ACOs to Adjust
Progress Payments**

Table I.1: Contracts Reviewed and Actions Taken to Adjust Progress Payments

Dollars in millions

Contract program	Contract number	Current contract price	Actions taken
Worldwide Information System ^a	F19628-84-C-0159 ^b	\$29.2 ^d	Reduced progress payments based on a loss ratio calculated by the contractor and subsequently suspended progress payments due to poor contractor performance.
Integrated Apogee Boost Subsystem ^a	F04701-84-C-0072 ^b	141.9	No progress payment adjustments made.
Advanced Medium Range Air-to-Air Missile ^a	F08635-87-C-0065 ^b	188.3	On both contracts, withheld a percentage of eligible progress payments because of failure to meet the contractual delivery schedule and adjusted liquidation rates when deemed appropriate.
	F08635-88-C-0116 ^b	280.4	
F-14D Tomcat	N00019-87-C-0131 ^c	690.3	On all three contracts, adjusted liquidation rates when deemed appropriate.
	N00019-88-C-0025 ^c	599.9	
	N00019-88-C-0276 ^c	1,109.8	

^aCost/schedule control system reporting is required for these programs.

^bFixed-price incentive contract.

^cFirm fixed-price contract.

^dThis price represents only the fixed-price incentive portion of the contract.

Comments From the Department of Defense

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



ACQUISITION
DP/CPF

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

NOV 18 1991

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

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report entitled--"DEFENSE CONTRACTING: Key Data Not Routinely Used In Progress Payment Reviews," dated September 27, 1991 (GAO Code 396148), OSD Case 8841. The Department agrees with the GAO observations and findings, and partially concurs with the recommendation.

Administrative contracting officers should be provided with the Defense Plant Representative Offices' technical analyses of reports generated by contractors' cost/schedule control systems. Those reports, along with production management data and on-site physical surveillance, should be part of the administrative contracting officer's administration of contracts, particularly as it relates to the review and approval of requests for progress payments. As noted by the GAO, while not formally required, some administrative contracting officers have already utilized contractor cost/schedule control system data as support for their application of a loss ratio in the payment of progress payments on projected loss contracts.

Because the automated payment system generates significant administrative savings, the Department does not agree that all high dollar contracts should undergo a monthly review of progress payment requests vis-a-vis cost/schedule control system data. Instead, the Department proposes that the administrative contracting officer pull the contract in question from the automated payment system only when the cost/schedule control system data, or any other significant input, indicates a negative performance trend. Manual review of progress payment requests for all high dollar contracts, regardless of indicators, would be administratively expensive, and divert attention from those contracts that have been identified for greater surveillance.

Appendix II
Comments From the Department of Defense

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

Sincerely,

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Enclosure

Appendix II.
Comments From the Department of Defense

GAO DRAFT REPORT - DATED SEPTEMBER 23, 1991
(GAO CODE 396148) OSD CASE 8841

"DEFENSE CONTRACTING: KEY DATA NOT ROUTINELY USED IN PROGRESS
PAYMENT REVIEWS"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

- o **FINDING A: Progress payments.** The GAO described progress payments as a method of interim financing on fixed price contracts in which the Government shares with the contractor the financial burden of contract performance. The GAO observed the Federal Acquisition Regulations contain provisions that govern the authorization, administration, and limitation on progress payments. The GAO explained that progress payments are made based on costs incurred, and are to be reduced or suspended when the estimated costs to complete the contract are likely to exceed the negotiated contract ceiling price--or the contractor fails to meet contract performance or schedule requirements. The GAO noted that the amount of payments are limited based on the value of work performed and items delivered. The GAO reported that contractors submit requests for progress payments monthly and are reimbursed at a rate between 85 and 100 percent of costs incurred, depending upon the terms of the contract.

The GAO concluded that, with the A-12 program, the contractors (1) had understated significantly the estimated cost to complete the work and (2) had not disclosed the existence of a cost overrun, which would have resulted in a reduction of progress payments. The GAO further concluded that, for the A-12 program, there also were weaknesses in procedures for reviewing progress payments, with the Government generally relying on contractor-generated estimates of completion costs, rather than on an independent analysis of contractor performance data--or on the actual physical progress of the contractor. (pp. 1-2/GAO Draft Report)

DOD RESPONSE: Concur. It should be noted, however, that progress payment rates on existent contracts can range from 75 to 100 percent. A customary progress payment rate (for large businesses) of 75 percent was in effect for contracts awarded between October 1986 and October 1988, and was raised to 80 percent for the period October 1988 through June 1991.

ENCLOSURE

See comment 1.

Appendix II
Comments From the Department of Defense

On July 1, 1991, the customary progress payment rate for large businesses was raised to 85 percent.

- o **FINDING B: Cost and Performance Data Not Used To Approve Progress Payments.** The GAO found that the administrative contracting officer reviews of contractor monthly progress payment requests were often limited to verifying the progress payment rate, contract price, and mathematical accuracy. The GAO further found that the administrative contracting officer reviews were not required to use (1) reports generated by the contractor cost/schedule control systems or (2) the Defense Plant Representative Office independent estimates of completion costs, which incorporated the Offices' assessments of production and delivery data. The GAO concluded that, because the information was not used routinely in reviewing monthly progress payment requests, the administrative contracting officers were not ensuring that the Government was provided with the most timely indicators of potential cost overruns.

The GAO observed that the Defense Plant Representative Offices technical specialists prepare monthly analyses of weapons programs, based on reports generated from contractor cost/schedule control systems, as well as on routine on-site physical surveillance of contractor operations. The GAO explained that the monthly reports from the Defense Plant Representative Offices contain data on budgeted, actual, and estimated completion costs--and also include cost trends and schedule and performance status. According to the GAO, those monthly reports are designed to serve as a management tool for control and oversight to ensure that the objectives of the program will be met.

The GAO reported that, while they may have discussions with the Defense Plant Representative Offices technical specialists, the administrative contracting officers regularly do not ask technical specialists to furnish their monthly reports in conjunction with the review and approval of progress payments. In three of the four contracts the GAO reviewed, the technical specialist monthly reports were used as the basis to withhold a percentage of progress payments or suspend progress payments because of the inability of the contractor to meet the delivery schedule. The GAO reported that, according to a Navy report, if the Government had used such information sooner in reviewing the progress payments on the A-12 program, overpayment would not have occurred.

The GAO further reported that analyses of estimated completion costs prepared by the Defense Plant Representative Offices can

Appendix II
Comments From the Department of Defense

be used to validate the contractor estimates to complete the contract and determine if a loss ratio should be applied. The GAO explained that a loss ratio is applied to the progress payment amount when total contract costs are expected to exceed the negotiated contract ceiling price--and when that condition occurs, the amount of costs eligible for monthly progress payments should be reduced based on the ratio of the negotiated contract price to the estimated price at completion. The GAO asserted that, if a loss ratio is not applied as soon as a loss is projected, then an overpayment will exist. The GAO reported that one contractor had applied a loss ratio, resulting in a reduction in progress payments. According to the GAO, however, the administrative contracting officer had not, on a routine basis, reviewed the cost and performance data as part of the monthly progress payment review.

The GAO further observed that, at least annually, the administrative contracting officers are to initiate in-depth progress payment reviews to ensure the reliability and accuracy of the contractor submissions. According to the GAO, such reviews generally include Defense Contract Audit Agency verification of incurred costs and estimated completion costs to contractor supporting data--and may include the Defense Plant Representative Offices technical assessments of the physical progress made on the contract. The GAO reported that, at one location, The Defense Contract Audit Agency found problems with the contractor methodology for calculating estimated completion costs on progress payment requests. The GAO further report that, as a result, the contractor corrected its estimating methodology for major contracts over \$10 million and is in the process of taking corrective action for other contracts. The GAO explained that, at the contractor location, the monthly reports prepared by the Defense Plant Representative Offices technical specialist could have been used (in addition to the Audit Agency annual review) to assess the accuracy of monthly progress payment requests--thereby reducing the risk of overpayment. The GAO concluded that the procedures for reviewing progress payments for other contracts was similar to the procedures used on the A-12 contract. (pp. 3-6/GAO Draft Report)

Now on pp. 2-5.

DOD RESPONSE: Concur. Monthly analyses of weapons programs based on information gathered from contractor management systems (cost/schedule, production management, etc.), on-site physical surveillance, and independent estimates at completion should be included in the progress payments review process. Specific procedures to ensure that the administrative contracting officer is provided with technical assessments of

Appendix II
Comments From the Department of Defense

See comment 1.

contractor cost and schedule performance on a monthly basis would strengthen Defense Contract Management Command administration of progress payments.

It should be noted the GAO states in footnote 4 that the DOD requires contractors to establish cost/schedule management information systems for fixed-price incentive contracts for which the total value of research and development exceeds \$40 million and production exceeds \$160 million. Applicable DOD Instruction 5000.2, Part 11, Section F 2.b(2) increased the thresholds to \$60 million and \$250 million, respectively, in fiscal year 1990 constant dollars.

See comment 2.

The GAO stated that the Defense Contract Audit Agency issued audit guidance to improve progress payment surveillance procedures, and that the guidance adds audit steps to evaluate contractor cost estimates at completion using trend analysis techniques. The GAO further stated the Defense Contract Audit Agency audits are conducted annually, or more frequently as requested by the administrative contracting officer. It should be noted that the Defense Contract Audit Agency utilizes trend analysis techniques only for those contracts subject to cost/schedule control systems reporting requirements, not all fixed price type contracts. In addition, the audits are scheduled according to risk evaluation and audit workload, as opposed to annually.

The GAO further observed that, at least annually, the administrative contracting officers are to initiate in-depth progress payment reviews to ensure the reliability and accuracy of contractor submissions using (1) production and delivery data and (2) Defense Contract Audit Agency audits of incurred and estimated completion costs. It should be pointed out that the Defense Contract Audit Agency reviews of estimates at completion are joint efforts with the Defense Plant Representative Office, with the contract auditors relying heavily on technical input from the Defense Plant Representative Offices.

- o **FINDING C: Recent Guidance Intended To Improve Surveillance Practices.** The GAO found that, since January 1991, when the Navy cancelled the A-12 contract for default, the Defense Contract Management Command and the Defense Contract Audit Agency have attempted to improve the Government progress payment surveillance procedures. The GAO reported that Defense Contract Management Command instructions now require the Defense Plant Representative Offices to make independent assessments and certifications of estimated completion costs and contractor performance in quarterly reports to the Defense Logistic Agency

Appendix II
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for Defense Acquisition Board and Service Acquisition Executive programs.

The GAO further reported that the surveillance guidance set forth by the DOD requires the Defense Plant Representative Offices periodically to review progress payment requests, using production and delivery data and Defense Contract Audit Agency audits of incurred and estimated completion costs. According to the GAO, the reviews conducted by the Defense Plant Representative Offices are required annually--or more frequently on individual contracts for programs managed by Defense Acquisition Board or Service Acquisition Executive. The GAO explained that, for other contracts--where the contractor is deemed financially sound--only annual reviews based on a sample of progress payments are required. The GAO concluded that, although the current guidance should improve surveillance practices, it does not provide for the use of available cost and performance data in monthly progress payment reviews.

The GAO reported that, in response to the A-12 overrun situation, the Defense Contract Audit Agency has issued audit guidance to improve the progress payment surveillance procedures by adding audit steps to evaluate the contractor cost estimate-at-completion, using trend analysis techniques. The GAO observed that the guidance emphasizes the risk of a contractor overstating the request for progress payment when a contractor is experiencing performance problems. (pp. 6-8/GAO Draft Report)

Now on pp. 5-6.

DOD RESPONSE: Concur. Current guidance does not provide for the use of available cost and performance data in monthly progress payment administration. As previously noted, specific procedures to ensure that the administrative contracting officers are provided with technical assessments of contractor cost and schedule performance on a monthly basis would strengthen the Defense Contract Management Command administration of progress payments.

* * * * *

RECOMMENDATION

- o **RECOMMENDATION:** The GAO recommended that, in its review of monthly progress payment requests, the Defense Contract Management Command establish and implement procedures requiring the administrative contracting officer to use (1) reports generated by contractor cost/schedule control systems, (2) the

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Comments From the Department of Defense

Now on p. 6.

independent estimated completion costs prepared by the Defense Plant Representative Offices, and (3) the production and delivery data for, at the minimum, all high-dollar value contracts. (p. 8/GAO Draft Report)

DOD RESPONSE: Partially concur. Existing procedures are currently under review by the Defense Contract Management Command and will be changed to ensure that the administrative contracting officers are provided with monthly analyses of contracts that appear to be developing negative performance trends. Contracts will be so identified via analyses based on information gathered from contractor management systems (cost/schedule, production management, etc.), as well as on-site physical surveillance of contractor operations. Using those analyses, the administrative contracting officer will determine the need to (1) perform an out-of-cycle review, (2) reassess the contract risk category, and/or (3) pull the contract from the automated payment system and perform monthly progress payment reviews. The Defense Contract Management Command anticipates issuance of a policy letter by November 15, 1991, to reflect the foregoing requirements, to be followed by formal revision of the appropriate Defense Contract Management Command manual as soon as is practicable.

The Department, however, considers it counterproductive to require the monthly analyses described above on all high dollar contracts, i.e., including those with no apparent negative performance trends. The latter should remain within the automated payment system, as that system represents a significant manpower savings. To require that progress payments on all high dollar contracts be processed manually would be administratively expensive, and would dilute the ability of the Defense Contract Management Command to focus its resources on the administration of those contracts that have identifiable contract management problems.

* * * * *

Appendix II
Comments From the Department of Defense

The following are GAO's comments on the Department of Defense's letter dated November 18, 1991.

GAO Comments

1. The report has been changed to incorporate this comment.

2. We have modified our report to indicate that the Defense Contract Audit Agency uses trend analysis techniques only for those contracts subject to cost/schedule control system reporting requirements, not all fixed-price contracts.

DOD also stated that the Defense Contract Audit Agency will schedule progress payment audits according to "risk evaluation" and audit work load, as opposed to annually. On the basis of our review of the new guidance and discussions with agency officials, we believe that the agency guidance does not explain how risk evaluations will be conducted. Nevertheless, the agency believes that risk evaluations will be a key component in ensuring that progress payments are appropriate and accurate.

Major Contributors to This Report

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Ralph Dawn, Assignment Manager

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