# Policy and Oversight Report

## Contract Audit Directorate

### Evaluation Report on the Army Materiel Command Contract Audit Followup Program

Report Number PO 97-005 January 31, 1997



Office of the Inspector General
Department of Defense

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**Acronyms**

| | |
|---|---|
| ACALA | Army Armament and Chemical Acquisition and Logistics Activity |
| ACO | Administrative Contracting Officer |
| AFARS | Army Federal Acquisition Regulation Supplement |
| AFU | Audit Followup |
| AMC | Army Materiel Command |
| BCM | Business Clearance Memorandum |
| CAFR | Contract Audit Followup Report |
| CAS | Cost Accounting Standards |
| CECOM | Army Communications-Electronics Command |
| DCAA | Defense Contract Audit Agency |
| FAR | Federal Acquisition Regulation |
| IOC | Army Industrial Operations Command |
| MICOM | Army Missile Command |
| OMB | Office of Management and Budget |

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

January 31, 1997

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Evaluation Report on the Army Materiel Command Contract Audit Followup Program (Report No. 97-005)

We are providing this report for review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The comments that we received from the Army were responsive. As a result of management comments, we deleted Recommendation 4 and replaced it with new Recommendations 4 and 5. See report recommendations, management comments, and audit response for the changes and response required. We ask that management provide comments in response to the final report by March 31, 1997.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Ms. Bonnie Weiss, Project Manager, at (703) 604-9183 (DSN 664-9183). If management requests, we will provide a formal briefing on the evaluation results. See Appendix E for the report distribution.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

## Office of the Inspector General, DoD

**Report No. 97-005** **January 31, 1997**
(Project No. 6OC-9039)

# The Army Materiel Command Contract Audit Followup Program

## Executive Summary

**Introduction.** The U.S. Army Materiel Command subordinate commands are responsible for processing about 50 percent of all Defense Contract Audit Agency audit reports the Army reports semiannually to the Inspector General, DoD. Each year the U.S. Army Materiel Command awards more than $18 billion in contracts. Contract audit reports are tracked from time of receipt to final disposition to provide accountability for and to ensure timely resolution and disposition of report findings and recommendations. The information in the tracking system serves as the source document for preparation of the semiannual status report.

**Evaluation Objective.** The primary objective was to determine whether the contract audit followup program at the five Army Materiel Command subordinate commands was in compliance with DoD Directive 7640.2. We selected the commands for review based on total reports, audit questioned costs, overage reports, overall sustention rate, and the date of our last evaluation. Sustention rates represent that percentage of costs questioned by the auditor that are upheld as a result of actions taken by the contracting officer or contractor. Sustention rates were one of our selection factors because they represent a tool for identifying areas that may warrant further analysis.

**Evaluation Results.** The contract audit followup programs at the Army Materiel Command subordinate commands we reviewed were generally adequate and had high level management interest and support. However, additional management emphasis is needed to improve the processing of cost accounting standards reports and the recovery of funds due the Government. Strengthening management oversight of the contract audit followup program will improve the effectiveness of the program in obtaining timely resolution of contract audit reports, with emphasis on protecting the Government's interest. We were particularly pleased with the contract audit followup program performance at the U.S. Army Tank-Automotive and Armaments Command, which could serve as an example for other commands. See Part I for a discussion of the evaluation results and Appendix C for a summary of the potential benefits resulting from the evaluation.

**Summary of Recommendations.** We recommend additional followup actions be taken at the U.S. Army Communications-Electronics Command and the U.S. Army Industrial Operations Command to ensure that outstanding interest and overpayments are collected and report processing is improved. We also recommend that management monitor the contract audit followup programs at these two commands and strengthen its oversight of the recovery of funds process.

**Management Comments.** The Director, U.S. Army Contracting Support Agency, provided comments for the Army on this report. The full text of the Army comments is in Part III. The Army concurred with the recommendations that followup actions be taken at the Communications-Electronics Command and the Industrial Operations Command to ensure that outstanding interest and overpayments are collected and that

report processing is improved. The Army also concurred with the recommendation to establish procedures to monitor the contract audit followup programs of subordinate commands as part of the Internal Management Control Program. The Army nonconcurred with the recommendation that Army Commands use the Army Overage Audit Review Board process to ensure that settlements are proper and meet Federal, DoD, and Army requirements for the recovery of funds. The Army instead proposed that the Communcations-Electronics and the Industrial Operations Commands provide the training necessary to overcome the deficiencies cited in recovery of funds actions and that recovery of funds be a special interest topic for Army Materiel Command procurement management reviews of Communications-Electronics and Industrial Operations Commands.

**Policy and Oversight Response.** The Army Contract Support Agency comments meet the intent of our recommendations. In response to the Army comments on our recommendation that the Army use the Army Overage Review Board process to ensure that settlements involving recovery of funds meet Federal, DoD, and Army requirements, we replaced the recommendation with two recommendations that are in line with the Army response. One recommendation requires the Communications-Electronics and the Industrial Operations Commands to provide comprehensive training to contracting officers on contract debt issues and recovery of funds. The other recommendation requires the Army Materiel Command to review contract settlements involving contract debt issues as a standard item in the procurement management review process. In the response to the final report, we request that the Army provide comments on the latter recommendation.

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# Part I - Evaluation Results

## Evaluation Background

The DoD policy for followup on contract audit reports is in DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports." The Directive emphasizes the financial advisory role of the contract auditor and the independent, decisionmaking role of the contracting officer. The Directive requires, however, that contracting officers fully consider contract audit advice and that they document the disposition of audit recommendations. The Inspector General, DoD, is responsible for developing policy for and monitoring, coordinating, and evaluating contract audit followup systems within the DoD. The Secretaries of the Military Departments and the Directors of the Defense agencies have overall management responsibility for their respective contract audit followup programs. This responsibility includes submitting semiannually to the Office of the Inspector General, DoD, a status report on specified postaward contract audit reports issued by the Defense Contract Audit Agency (DCAA). The information from the semiannual reports provides management a tool to gauge overall performance of the contract audit followup program.

The Army Materiel Command (AMC), with Headquarters in Alexandria, Virginia, supports the Army with equipment and technology. The AMC, operating through eight major subordinate commands, directs the activities of its depots, laboratories, arsenals, manufacturing facilities, maintenance shops, proving grounds, test ranges, and procurement offices throughout the world. Its complex missions range from the development of sophisticated weapon systems to laser research to the distribution of spare parts. Each year, the AMC awards more than $18 billion in contracts. Collectively, the AMC subordinate commands are responsible for processing about 50 percent of all postaward audits reported to the Inspector General, DoD, semiannually by the Army.

## Evaluation Objectives

The primary objective was to determine whether the contract audit followup program at the Army Communications-Electronics Command, the Army Industrial Operations Command, the Army Missile Command, the Army Tank-Automotive and Armaments Command, and the Army Armament and Chemical Acquisition and Logistics Activity was in compliance with DoD Directive 7640.2. Specifically, we determined whether adequate tracking and reporting systems were established; audit reports were properly resolved and dispositioned; settlements were processed in accordance with Federal, DoD, and Army regulations and requirements; the performance standards and appraisals of appropriate contracting personnel addressed contract audit followup responsibilities and effectiveness; and corrective action had been taken on our previous report findings and recommendations at the Army Armament and Chemical Acquisition and Logistics Activity (ACALA), the Army

Communications-Electronics Command (CECOM), and the Army Industrial Operations Command (IOC). See Appendix A for the scope and methodology of our evaluation and Appendix B for the summary of prior reviews.

# Contract Audit Followup Program and Compliance With DoD Directive 7640.2

The five AMC subordinate Commands and activities (collectively referred to as Commands) have established adequate tracking and reporting systems in compliance with DoD Directive 7640.2. However, improvements are needed in resolving audit reports; adhering to Federal, DoD, and Army guidance on the recovery of funds; and evaluating contracting personnel on effectiveness in contract audit followup. Also, additional management oversight is needed to ensure that interest and overpayment amounts are collected and settlements are made in accordance with Federal, DoD, and Army requirements. At the Army Communications-Electronics Command and the Army Industrial Operations Command, the contracting officers failed to follow the Army Federal Acquisition Regulation Supplement (AFARS) Business Clearance requirements or comply with Federal, DoD, and Army requirements for the recovery of funds due the Government as a result of overpayments and Army management did not ensure that all appropriate personnel were evaluated on effectiveness in contract audit followup. As a result, audit reports were not resolved before being closed, amounts due the Government were not collected, and interest was not being transferred to the U.S. Treasury. Also, failure of management to evaluate contracting personnel on their contract audit followup responsibilities contributed to the deficiencies found. Additional management emphasis and oversight is needed to improve the contract audit followup program and to ensure regulatory requirements are met.

## Tracking and Reporting of Contract Audit Reports

**Tracking System.** The DoD Directive 7640.2(2.a.) requires that all contract audit reports be tracked; however, it requires that only the status of specified reports be reported to the Inspector General, DoD. The AFARS 15.891-2(a) requires that each purchasing or contract administration office establish a single entity for requesting, receiving, and tracking all audit reports. With the exception of the Army Missile Command (MICOM), all AMC subordinate commands reviewed have a tracking system that meets the DoD and Army requirements. The MICOM does not have a single entity for requesting, receiving, and tracking all audit reports. Instead, all postaward audits are requested, received, and tracked by the contract audit followup monitor and all preaward audits are requested, received, and tracked by the Pricing Division. The MICOM deviation does not have an adverse impact on tracking accountability; however, it does not meet AFARS requirements.

**Reporting System.** The individual acquisition and contract administration organizations are required to maintain timely and complete information regarding the status of reportable audit reports from the date of receipt through final disposition. This information is the basis for the semiannual status report.

The semiannual status reports for the periods ended March 31, 1995, and September 30, 1995, contained errors such as incorrect report status, report dates, and sustention data. Although we were able to research and correct most errors before submission of the data to Congress, emphasis needs to continue to ensure the accuracy of the data. The Army has issued clarifying guidance on reporting requirements, placed additional edit checks in its system, and provided training to field contracting activities. These initiatives have significantly improved reporting accuracy, and the most recent status report for the period ended March 31, 1996, was virtually error free. Also, Army personnel have worked with other DoD Components to improve the overall quality of the DoD semiannual report. No further recommendations are necessary at this time.

## Resolution and Disposition of Contract Audit Reports

**Resolution of Audit Reports.** The DoD Directive 7640.2 (4.a) requires that "the DoD component procedures for documenting and reviewing proposed prenegotiation objectives shall provide for independent review for internal control purposes prescribed by Office of Management and Budget Circular A-50." The Army accomplishes this independent review through its Business Clearance process, AFARS 15.890-1(d). The AFARS requires a Business Clearance Memorandum (BCM) be prepared for all audits requiring resolution and disposition under the DoD Directive, regardless of dollar value. The purpose of the BCM is to document that a proposed contractual action represents good business judgment and conforms to Federal, DoD, and Army acquisition policies and that the established price is fair and reasonable. An integral part of the BCM is a discussion of the rationale for acceptance or nonacceptance of the DCAA findings and recommendations. To meet the Office of Management and Budget (OMB) internal control requirements, the AFARS requires that, at a minimum, the Pre-BCM be approved at a level higher than that of the individuals assigned to the negotiation. The Post-BCM shall be approved at the same level as the Pre-BCM before the execution of the contract. In accordance with the AFARS, "approval of the Post-BCM may be waived when the final negotiated agreement is within the limits set forth in the Pre-BCM and there has not been a material change in terms, conditions, or assumptions under which the Pre-BCM objective was developed."

The AFARS Business Clearance requirements were not followed in four instances: two at the CECOM and two at the IOC. Therefore, these audits were not properly resolved before being dispositioned. At the CECOM, the contracting officer did not follow proper Business Clearance Procedures in processing Audit 6181-92C42040-006, a defective pricing report recommending a price adjustment of $30,132. In this case, the contracting officer accepted additional goods and services in lieu of collecting the overpayment amount and interest due. Also in processing Audits 3531-94W19200-007 and 3531-94W19200-010, cost accounting standards (CAS) reports, the IOC contracting officer advised the DCAA that he did not consider the reimbursement of $68,610 and $75,027, respectively, for Bid and Proposal expenses in excess of "negotiated limits" to be a noncompliance problem. The necessary business

clearance documentation was not prepared and approved before resolving and dispositioning the reports. Failure to follow proper Business Clearance procedures is a repeat finding at the CECOM.

In our Contract Audit Followup Reports (CAFR) 95-36, dated September 6, 1995, and 96-02, dated November 6, 1995, we recommended that appropriate CECOM and IOC management officials review and comment on the disposition documentation for the four audits. The Army responded positively to our recommendations and furnished copies of documentation to support proper disposition of the two CECOM defective pricing reports. Documentation to support disposition of the two IOC CAS reports was promised by IOC but never furnished. Followup with the IOC disclosed that the two reports recommending cost recoupments of $143,637 were improperly closed and the contractor is in noncompliance with cost accounting standards. If the contractor is in noncompliance with cost accounting standards, then the two reports should be reopened and properly processed.

**Disposition of Audit Reports.** The DoD Directive 7640.2 requires explicit and timely documentation and feedback on the final disposition of audit reports. The contracting officer is required to prepare a memorandum that discusses the disposition of all recommendations and questioned or qualified amounts, including the underlying rationale. A copy must be furnished to the cognizant auditor before the audit report is closed. The Army contracting officers were routinely furnishing the DCAA copies of the disposition documentation. The disposition documentation discussed the DCAA findings and recommendations and the rationale for acceptance or nonacceptance.

**Processing of Cost Accounting Standards Reports.** When processing CAS reports, the Federal Acquisition Regulation (FAR) 30.602-2 requires the Administrative Contracting Officer (ACO) to make an initial finding of compliance or noncompliance and notify the auditor within 15 days and to notify the contractor immediately in writing and allow the contractor 60 days in which to respond if a finding of noncompliance is made. The ACO must also notify the contractor in writing of any technical noncompliance. This notification should advise the contractor that he is in technical noncompliance; corrective action should be taken; and if such noncompliance subsequently results in materially increased costs to Government, FAR 52.230-2 and 52.230-3 will be enforced.

At the IOC, the ACOs were improperly processing 11 of the 27 CAS reports issued to the IOC. Specifically, the ACOs failed to make the initial finding of noncompliance in the manner or time required by the FAR for seven CAS reports, the ACO improperly closed one CAS report, and the ACOs did not issue proper technical noncompliance notices for three CAS reports. The CAS reports were improperly processed because the ACOs were unfamiliar with the FAR requirements and did not have the necessary experience or training to process this type of report. Failure to properly process CAS reports jeopardizes the right of the Government to collect overpayments and associated interest as a result of CAS noncompliances. In CAFR 96-02, we made several recommendations regarding specific CAS reports being improperly processed. Specifically, we recommended that IOC provide the current status of seven CAS

reports being processed, reopen one report and begin processing it in accordance with the FAR requirements, report one report as open until corrective actions have been verified with the DCAA, and issue proper technical CAS noncompliance notices for three reports. We also recommended that Army Headquarters provide assistance to ensure the IOC ACOs working the CAS issues receive CAS training. The Army concurred with our findings and provided the current status of the seven CAS reports, furnished the BCM dispositioning one report, advised one report would be reported as open until corrective actions were completed and verified by the DCAA, and issued proper technical CAS noncompliance notices for the three cited reports. Thee IOC also conducted training for contracting officers.

## Processing Settlements in Accordance With Federal, DoD, and Army Regulations and Requirements

**Interest Due the Government.** The FAR 15.804-7(b)(7)(iv) requires that, in the price reduction modification or demand, the contracting officer separately include the interest amount through a specified date. In addition, statute requires interest and penalty assessments for defective pricing and CAS noncompliances. These amounts cannot be negotiated away in "bottom line" settlements and contracting officers are not authorized to waive these charges or offset them against amounts owed the contractor.

In our previous evaluation reports (CAFR 95-36 and CAFR 96-02), we identified five settlements at the CECOM and the IOC totaling $421,537, where interest was not properly assessed, collected, or credited to the appropriate account when funds were recouped. This failure to properly recoup interest due occurred because the ACOs did not understand the Federal, DoD, and Army requirements for recovery of funds. Failure to properly assess, collect, or credit the appropriate account results in lost revenue for the U.S. Treasury. For example, one IOC contracting officer negotiated a bottom line settlement that did not separately identify interest charges and contracting officers at CECOM and the IOC erroneously reduced the contract price by the amount of the defective pricing plus the amount of applicable interest. Reducing the contract price by more than the amount of the defective pricing could result in improper augmentation of the contract appropriation by the amount of the interest and penalties; illegal augmentation could also result if credits and adjustments are accepted on contracts not affected by the defective pricing.

In CAFR 95-36 and 96-02, we recommended that demand letters be issued to collect the interest due on two settlements and that the appropriate interest amounts be transferred to the U.S. Treasury on the other three settlements. Management concurred with our recommendations and interest of $91,523 was credited to the Treasury on one of the cited IOC settlements. We were advised that demand letters have been issued to collect the interest due on two settlements and actions are underway to transfer the appropriate interest amounts to the Treasury on the other two settlements.

**Recoupment of Overpayments.** The FAR 32.610(a) requires that a demand for payment be made "as soon as the responsible official has computed the amount of refund due." The purpose of a demand for payment is to provide the contractor with instructions on how, when, and where to repay a contract debt and to establish an account receivable. For defective pricing or CAS noncompliance settlements, the contract adjustment must reduce contract price or offset as appropriate. Where payments for delivered goods or services have been made, a demand for the amounts overpaid is also required.

In CAFR 95-36, we identified three instances where CECOM contracting officers reduced the contract price by the amount of the agreed-to adjustment but failed to demand and recover the overpayments made for delivered goods and services already paid for under the contract. The contracting officers believed that the price reduction modification resulted in recoupment of the overpayment. In one instance, the contracting officer accepted additional goods in lieu of collecting the overpayment amount. Specifically, the contracting officer agreed with the DCAA finding of defective pricing and originally issued a modification for a downward price adjustment and a demand for payment of $36,926 (including accrued interest). Upon receipt of the modification, the contractor prepared an unsolicited letter proposal that was subsequently accepted by the Government. The contracting officer rescinded the modification and the demand for payment and agreed to accept additional goods valued at $19,600 in full settlement of the defective pricing.

We advised management officials that a price reduction modification does not constitute recoupment but simply prevents further overpayments on future deliveries. The contractor is required to liquidate debts either by cash payment in a lump sum on demand or by credit against unpaid bills due the contractor, unless an agreement has been made to defer collection. Acceptance of additional goods or services instead of collecting the overpayment amount may improperly augment appropriations, avoid justifying the need for the supplies or services, circumvent competition requirements by not requiring justification and approval of sole-source procurements.

In CAFR 95-36, we recommended that CECOM contracting officers issue proper demands for payment in accordance with FAR 32.610(b) and furnish our office copies of the repayment checks when received. Since our review, $21,640 has been recouped on one settlement and a credit of $16,950 was taken against unpaid bills due the contractor on another settlement. On the remaining settlement of $71,693, CECOM management advised that they do not have sufficient invoices currently due and on hand against which the debt could be offset. This practice results in delayed recoupment by the Government and loss of applicable interest. We advised the CECOM that it needs to issue a demand for the amount due plus applicable interest.

## Evaluating Effectiveness in Contract Audit Followup

The Office of Management and Budget Circular A-50, "Audit Followup," and the DoD Directive 7640.2 require that performance appraisals reflect effectiveness in resolving and dispositioning audit findings and recommendations. The specific language from the Directive, "Resolves and dispositions contract audit recommendations in a timely manner, while fully protecting the Government's interest," or similar language should be incorporated into performance plans.

The performance plans of appropriate contracting personnel did not contain a specific element on contract audit followup. Therefore, the performance appraisals of these individuals did not reflect their effectiveness in this area.

In CAFRs 95-36 and 96-02, we recommended that contract audit followup responsibilities be added to the performance plans of appropriate contracting personnel so that their appraisals reflect effectiveness in this area. The Army responded positively to our recommendation and in January 1996 issued Acquisition Letter 96-01, which revises the Army policy on contract audit followup. The revision requires that the performance objectives and standards of contracting officers and other acquisition officials involved in contract audit followup contain a specific element addressing their CAF responsibilities. The action taken is adequate and responsive to our findings.

## Management Oversight of the Contract Audit Followup Program

Contract management officials at the commands were interested in and supportive of the contract audit followup program. However, additional management involvement and monitoring are necessary at the CECOM and the IOC to ensure corrective actions are taken. Monitoring could be accomplished by requiring the AMC Headquarters staff to periodically review the underlying resolution and disposition documentation for specific reports, to include CAS reports at the IOC. The documentation reviewed should include the Pre- and Post-BCM, the contract modification, the demand for payment, and other pertinent contract data. The Chief, Policy and Procedures Division, would then be furnished the results of these reviews for any further management action. The AMC could use the procurement management review process to provide management oversight for contract actions involving contract debt issues to ensure that settlements are processed in accordance with Federal, DoD, and Army requirements.

Implementation of an effective contract audit followup program involves interest and support at the highest management level. Management attention and support are needed for aggressive pursuit of timely and proper resolution and disposition of contract audit reports.

Several findings at the CECOM were repeat findings. Specifically, during a July 1991 review, we recommended that CECOM management ensure that contracting officers understand that they cannot recover amounts due the Government as a result of defective pricing by accepting additional goods and services. As a result of a 1993 review, we recommended that CECOM contracting personnel be reminded that a BCM must be prepared and approved in accordance with AFARS. Not preparing the BCM and obtaining the necessary approvals before negotiation attributed to settlements that did not meet Federal, DoD, and Army requirements for the recovery of funds.

The processing of CAS reports at the IOC and adherence to Federal, DoD, and Army guidance on the recovery of funds at the CECOM and the IOC needs additional management attention and oversight.

## Summary

The improper processing of CAS reports and failure to follow Federal, DoD, and Army requirements for the recovery of funds indicate improvements are needed. While CAS training has been provided to the IOC ACOs, the Army needs to followup to ensure that CAS reports are now being properly processed at the IOC. Also, emphasis needs to continue on adherence to Federal, DoD, and Army requirements for the recovery of funds. Although management interest and support of the contract audit followup program is evident at the AMC commands, additional oversight and followup is needed at the CECOM and IOC to ensure the audit followup program meets DoD and Army requirements.

## Recommendations, Management Comments, and Audit Response

**We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition):**

**1. Require the U.S. Army Materiel Command Headquarters to followup with the U.S. Army Industrial Operations Command on the two cost accounting standards reports that were improperly dispositioned to ensure they are properly resolved.**

**2. Require the U.S. Army Materiel Command Headquarters to followup with the U. S. Army Communications-Electronics Command and the U.S. Army Industrial Operations Command to ensure that the demand letters for amounts due plus interest and the interest transfers are processed in accordance with Federal, DoD, and Army requirements for the recovery of funds.**

**3. Establish procedures to monitor the contract audit followup programs of subordinate commands as part of the DoD Internal Management Control Program.**

**4. Require the Army Communications-Electronics and Army Industrial Operations Commands to provide comprehensive training to contracting officers on contract debt issues, including recovery of contractor overpayments, and the assessment, collection, and disposition of statutory interest.**

**5. Require the Army Materiel Command to include a review of contract settlements involving debt collection issues as a standard item during procurement management reviews of Army Materiel Command subordinate contracting commands.**

**Management Comments.** The Director, U.S. Army Contract Support Agency, provided comments for the Army on this report. The full text of the Army comments is in Part III. The Army concurred with Recommendations 1 and 2 stating that AMC will followup with its subordinate commands, IOC and CECOM, to ensure that cited audit reports are properly dispositioned and that cited recovery of funds actions are properly executed. The Army also concurred with Recommendation 3 stating that within AMC, the responsibility for contract audit followup has been reassigned to link it more closely with the Procurement Management Review Program and AMC contract close-out procedures to provide appropriate internal management controls. The Army nonconcurred with Recommendation 4, proposing instead that CECOM and IOC provide the training necessary to overcome the deficiencies cited in recovery of funds actions and that recovery of funds be a special interest topic for AMC procurement management reviews of CECOM and IOC.

**Policy and Oversight Response.** The Army Contract Support Agency comments meet the intent of our recommendations. We agree that comprehensive training on contract debt issues at CECOM and IOC should improve contract settlements involving recovery of funds issues. We also agree that recovery of funds settlements require the attention of the AMC procurement management review program, but as a standard item for reviews of all AMC subordinate contracting commands instead of as a special interest item for only CECOM and IOC. Management is requested to comment on new Recommendation 5.

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# Part II - Additional Information

# Appendix A. Scope and Methodology

We reviewed the most recent semiannual status reports submitted by the Army for the periods ended March 31, 1995, and September 30, 1995. Based on our review, we selected five AMC commands for on-site visits. Selection criteria included the numbers of audits reported in the semiannual status reports, sustention rates, number of overage audits, and the period since our last review. For the period ending September 30, 1995, 267 audit reports were reported for the AMC subordinate commands. We selected five AMC subordinate commands and reviewed 162 audit reports representing $167 million in audit-questioned costs. For the AMC commands selected, we:

o reviewed the tracking and reporting system, including written policies and procedures;

o evaluated the accuracy of the semiannual submission;

o examined individual contract audit files for open and closed audits;

o discussed the processing of the audits with appropriate contracting personnel;

o determined whether appropriate contracting personnel were evaluated on effectiveness in contract audit followup;

o assessed management oversight of the contract audit followup program; and

o determined whether appropriate actions had been taken on our previous evaluation report findings and recommendations.

See Appendix D for locations we visited.

# Appendix B. Summary of Prior Reviews

The Office of the Inspector General, DoD, contract audit followup staff has issued review reports that discuss the contract audit followup program at specific AMC subordinate commands. Also, several project review reports were issued that discuss recovery of funds, followup responsibilities in performance appraisals, and the Army Overage Audit Review Boards.

## Inspector General, DoD

**CAFR 96-02, "Contract Audit Followup Review U.S. Army Industrial Operations Command, Rock Island, IL," November 6, 1995.** The report made several recommendations to improve reporting accuracy; adherence to AFARS business clearance requirements on the recovery of funds; processing of cost accounting standards reports; adherence to Federal, DoD, and Army requirements on the recovery of funds; and evaluating appropriate contracting personnel on contract audit followup responsibilities.

The Army responded positively to our recommendations and, with the exception of those items discussed in this report, have taken appropriate corrective actions.

**CAFR 95-43, "Contract Audit Followup Review U.S. Army Armament and Chemical Acquisition and Logistics Activity, Rock Island, IL," September 29, 1995.** The report recommended that the ACALA expand the language in its performance evaluation system to include the specific language from DoD Directive 7640.2. The ACALA management agreed with our recommendation and expanded the language in its performance evaluation system.

**CAFR 95-36, "Contract Audit Followup Review of the U.S. Army Communications-Electronics Command, Fort Monmouth, NJ," September 6, 1995.** The report recommended that the AFARS Business Clearance requirements be followed; all appropriate contracting personnel be evaluated on contract audit followup responsibilities; and Federal, DoD, and Army guidance on the recovery of funds be followed.

The CECOM management agreed with our recommendations and implemented some corrective actions. Followup is needed to ensure the remaining recoveries are made.

**AFU 95-03, "Report on Followup Review of the U.S. Army Overage Audit Review Board Process," June 29, 1995.** The report stated that the requirements of AFARS 15.891-4 were not always followed, Board data

submitted to the Army Procurement Research and Analysis Office was not being used effectively, and minimal documentation was available to support the results of the Board process.

The report recommended that action be taken to ensure that the Board requirements were followed, the Board data be analyzed and utilized, and contracting activities document the assistance and guidance furnished by the Board.

The Army responded positively to our report and issued direction requiring that the contracting activities document the assistance and guidance provided by the Boards. The Army emphasized that the AFARS Board requirements were to be followed and monitored periodically to Army higher level management by the Army Procurement Research and Analysis Office.

**AFU 95-02, "Review of Contract Audit Followup Responsibilities in Performance Appraisals," June 29, 1995.** The report identified policies that warranted strengthening. The report identified the need for Army interim guidance on contract audit followup responsibilities and use of an Army-wide system that would recognize the requirement to include contract audit followup responsibilities in the performance plans of appropriate contracting personnel.

Pending revision of the AFARS, the Army issued guidance in Acquisition Letter 96-1, January 1996, requiring that acquisition officials and contracting officers involved in contract audit followup be evaluated on effectiveness in this area. The Army also advised that the COREDOC system would be used throughout the Army to prepare performance plans.

**AFU 94-02, "Review of Recovery of Funds Due the Government as a Result of Contract Debts," April 22, 1994.** The report identified deficiencies in the debt collection process. Several recommendations for corrective actions were made to improve debt collection. In response, the Comptroller and the Director, Defense Procurement, issued appropriate guidance.

# Appendix C. Summary of Potential Benefits Resulting From Evaluation

| Recommendation Reference | Description of Benefit | Amount and Type of Benefit |
|---|---|---|
| 1. | Compliance With Regulations or Laws. Requires proper processing of cost accounting standards reports to recover unallowable costs, if appropriate. | $143,637. |
| 2. | Compliance With Regulations or Laws. Requires recoveries of interest and overpayment amounts due the Government as a result of contract debts. | $116,646. |
| 3. | Program Results. Requires additional oversight to improve contract audit followup. | Nonmonetary. |
| 4. | Program Results. Requires training to improve future contract settlements involving contract debt issues. | Nonmonetary. |
| 5. | Program Results. Requires additional oversight to improve future contract settlements involving contract debt issues. | Nonmonetary. |

# Appendix D. Locations Visited

## Department of the Army

U.S. Army Communications-Electronics Command, Fort Monmouth, NJ
U.S. Army Industrial Operations Command, Rock Island, IL
U.S. Army Missile Command, Redstone Arsenal, IL
U.S. Army Tank-Automotive and Armaments Command, Warren, MI
U.S. Army Armament and Chemical Acquisition and Logistics Activity, Rock Island, IL

# Appendix E. Report Distribution

## Office of the Secretary of Defense

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Deputy Chief of Staff for Acquisition, U.S. Army Materiel Command
  Principal Assistant Responsible for Contracting
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    U.S. Army Industrial Operations Command
    U.S. Army Missile Command
    U.S. Army Tank-Automotive and Armaments Command
      Director of the Acquisition Center, Armament and Chemical Acquisition and Logistics Activity
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  Commander, Defense Contract Management Command
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  Inspector General, Defense Intelligence Agency

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- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Committee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

# Part III - Management Comments

# Department of the Army Comments

DEPARTMENT OF THE ARMY
US ARMY CONTRACTING SUPPORT AGENCY
[redacted]
FALLS CHURCH VA [redacted]

1 8 NOV [redacted]

SFAE-CSA-FPP

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE,
ATTN: AUDITING, 400 ARMY NAVY DRIVE,
ARLINGTON, VA 22202-2884

SUBJECT: Evaluation Report of the Army Material Command Contract Audit Followup Program (Project No. CAF-021)

Reference is made to the subject draft report, dated August 22, 1996, to which the following comments are offered.

We are pleased with the commendatory comments addressing the quality contract audit followup program conducted by the U.S. Army Tank-Automotive and Armaments Command.

The U.S. Army Missile Command has used its authority as a Re-invention Laboratory to deviate from the AFARS requirement for establishing a single entity for requesting, receiving, and tracking all audit reports. As you noted in the report, that deviation does not have an adverse impact on their tracking accountability.

Regarding your recommendations 1 and 2 for corrective actions, the Army Material Command (AMC), and their subordinate U.S. Army Industrial Operations Command (IOC) and U.S. Army Communications-Electronics Command (CECOM) concur with your findings. Formal documentation of business clearance has been removed from Army FAR Supplement (AFARS). AMC major subordinate commands, in compliance with other controlling regulations, have taken immediate action to cure the deficiencies cited in the report related to resolution and disposition of contract audit reports.

In response to recommendation 3, this Agency has established AFARS procedures at 15.890-3 and 15.890-4(c) to monitor the contract audit followup programs of subordinate commands. Material weaknesses will be reported as part of the Internal Management Control Program. Within Headquarters, AMC, the responsibility for followup has been

reassigned to link it more closely with the Procurement Management Review program and AMC contract close-out procedures in order to raise command visibility.

We are not in agreement with recommendation 4. The Overage Audit Review Boards, chaired by our Principal Assistants for Contracting, and composed of the contracting activity's senior legal, contracting and pricing personnel are used to provide expertise, guidance and assistance to the contracting officer only to help resolve and dispose of overage audits. Your recommendation, that the Board's responsibilities be expanded to also provide guidance and assistance to contracting officers before they execute the contractual documents effecting the recovery of funds, would place an unreasonable burden on our limited acquisition personnel resources at several levels. In order to ensure that settlements are proper, the PARCs at CECOM and IOC will provide the training necessary to overcome the shortcoming cited in the report on page 1 regarding recovery of funds. In addition, the subject will be included as a special interest topic for AMC procurement management reviews of CECOM and IOC.

Point of contact is Ray Kelly, (703) 681-7563.

R.D. KERRINS, JR.
Colonel, AC
Director

# INTERNET DOCUMENT INFORMATION FORM

**A . Report Title Evaluation Report on the Army Materiel Command Contract Audit Followup Program**

**B. DATE Report Downloaded From the Internet: 02/29/99**

**C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #):** **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
**Inspector General, Department of Defense**
**400 Army Navy Drive (Room 801)**
**Arlington, VA 22202-2884**

**D. Currently Applicable Classification Level**: Unclassified

**E. Distribution Statement A**: Approved for Public Release

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