

GAO

Testimony

Before the Subcommittee on Oversight and Investigations,  
Committee on Energy and Commerce,  
House of Representatives

For Release  
on Delivery  
Expected at  
10 a.m. EST  
Thursday,  
December 3, 1992

FEDERAL CONTRACTING

Cost-effective Contract  
Management Requires  
Sustained Commitment

Statement of J. Dexter Peach,  
Assistant Comptroller General,  
Resources, Community, and Economic  
Development Division



---

---

Mr. Chairman and Members of the Subcommittee:

We are pleased to have this opportunity to discuss with this Subcommittee our concerns about the contracting practices of civilian agencies and to highlight actions those agencies could take to improve their oversight and management of contractors. The report released today by the Office of Management and Budget (OMB) on civilian agency contracting hopefully signals the beginning of a commitment across the executive branch to correct long-standing problems.

As you know, we have appeared before this Subcommittee a number of times in the past few years to discuss persistent problems with civilian agencies' contracts and grants. Our work for this Subcommittee on grants to major universities also explored similar problems with indirect cost charges and audit oversight.

Our testimony today will summarize our work on four major contracting areas and identify steps that could be taken to strengthen contract management governmentwide. These four areas are

- extensive reliance on contractors to carry out agency missions,
- ineffective contract administration,
- insufficient oversight of contract auditing, and
- lack of high-level management attention to and accountability for contract management.

In summary, Mr. Chairman, civilian agencies currently spend about \$55 billion per year on contracts and have become increasingly dependent on contractors to help agencies manage and carry out their missions. Although contractors have an appropriate role to play in delivering needed services, once contracts are awarded federal agencies often focus more on accomplishing their programs' missions than on overseeing the quality and cost of completed work. Consequently, agencies have not effectively administered the contracts to control contractors' costs and performance. As a result, contractors are receiving bonuses for mediocre performance and are charging the federal government for millions of dollars in costs, such as employee parties, tickets to sporting events, and alcoholic beverages, that are either unallowable or questionable. These problems are as prevalent with federal grants as they are with contracts.

Additionally, more thorough and timely contract auditing could help minimize government vulnerability to fraud, waste, and abuse. Currently, there is a significant backlog of audits of costs incurred by contractors. For example, according to the

latest available information, the Defense Contract Audit Agency (DCAA), which performs the majority of audits for both defense and civilian agencies, had a backlog of approximately 13,000 incurred cost audits on contracts worth nearly \$159 billion. In addition to increasing their emphasis on audits, civilian agencies could improve audit effectiveness by clarifying which agency has contractor audit cognizance, more clearly delineating unallowable and questionable costs, and clarifying the government's position on the use of contractor discounts, known as voluntary management reductions.

At the core of contracting problems, we have found a lack of senior-level management attention to agencies' contracting activities. In some cases, senior officials have remained blissfully ignorant of waste and abuse because agencies do not have management information systems that "flag" contracting problems. In other cases, senior officials have not made managers accountable for effective contract administration, nor have they made a sufficient commitment to correct contracting problems that have surfaced.

Because of the spotlight placed on contract management by your Subcommittee, and numerous reports by the Inspectors General and us, OMB spearheaded an effort by 12 civilian agencies and DCAA to identify agency contracting problems and make recommendations to resolve them governmentwide and at each participating agency. To OMB's credit, this represents a serious attempt to build upon the efforts of agencies, such as the Environmental Protection Agency (EPA), which have begun to address some of the issues noted earlier. For these actions to be effective, however, the new administration needs to take ownership of these initiatives to ensure that reforms are implemented.

Before discussing in more detail the four major areas requiring attention to improve civilian agency contracting, let us provide some background information on the extent of federal contracting, the types of contracts used, our previous work on contract management, and efforts under way to begin to address these problems.

#### BACKGROUND

As mentioned earlier, federal civilian agencies spend over \$55 billion annually for a broad range of contract services, including professional, administrative, and management support services. The contractors who provide these services play a valuable role in government--they can provide expertise that agencies may not be able to afford, cannot get, or may not need on a permanent basis. Contractors may also be able to provide these services more cost-effectively.

The purchase of services by executive agencies is generally governed by cost principles contained in the Federal Acquisition Regulation (FAR). In purchasing services, the government uses two basic pricing arrangements: fixed-price and cost-reimbursable contracts. Fixed-price contracts require a contractor to assume responsibility for performing the agreed-upon work within an established price. Cost-reimbursable contracts, which reimburse contractors for all allowable costs incurred, are used because they offer agency managers flexibility in responding to emergencies and are appropriate when the scope and nature of the work to be performed are uncertain or subject to change. However, cost-reimbursable contracts (1) place maximum risk with the government and minimum risk with the contractor; (2) provide the contractor with little incentive to control costs; and (3) place a large administrative burden on both the government and the contractor to oversee, control, and identify costs.

Since 1980 we have issued dozens of reports and testimonies on civilian agency contracting and contract administration issues. (The appendix contains a list of selected GAO products.) Additional reviews of these areas have been undertaken by relevant Offices of Inspector General, internal agency groups, and congressional subcommittees. Collectively, these reports identify serious, long-standing, governmentwide deficiencies in contract administration and oversight.

In response to problems identified in reports by your Subcommittee, in our reports, and by agency Inspectors General, on June 3, 1992, the Director of OMB created interagency "swat" teams to examine and assess contract management and auditing practices at 12 civilian agencies. The project noted that:

There is mounting evidence that the capability of civilian agencies, in particular, to identify and disallow unallowable contract costs is limited. Numerous examples exist of unallowable costs having been submitted by contractors and paid by Federal agencies.

The teams were charged with determining the nature of existing weaknesses, finding ways of improving the administration of cost-reimbursement contracts, and ensuring that the federal government was not reimbursing its contractors for unallowable costs.

Mr. Chairman, with this perspective, let us begin by discussing the federal government's increased reliance on contractors.

CONTRACTORS ARE USED EXTENSIVELY TO  
ACCOMPLISH GOVERNMENT PROGRAMS' MISSIONS

Civilian agencies increasingly rely on contractors to perform specialized tasks and functions that are critical to the success of their programs' missions and objectives. Although there is nothing inherently wrong with this approach, contracting does not alleviate the civilian agencies' responsibility for overseeing contractors' activities in order to protect the government's interest.

In the past decade, as the government workload has increased, dollars expended on contracting have increased significantly. Federal budget outlays increased from about \$591 billion in fiscal year 1980 to an estimated \$1.4 trillion in fiscal year 1991, while contract actions for services increased in value from \$23 billion in fiscal year 1979 to \$55 billion in fiscal year 1991. At the Department of Energy (DOE), for example, contract actions for services increased from about \$5.7 billion in fiscal year 1979 to about \$18.3 billion in fiscal year 1991. At EPA, contract actions for services rose even more dramatically, from \$130.8 million in fiscal year 1979 to about \$1.1 billion in fiscal year 1991.

The extensive use of contractors to support the government's operations has raised a number of concerns. Some of the questions being asked include: Is it cheaper to use contractors, or can federal employees perform the required activities more cost-effectively in-house? Are contractors being used to do work related to policy formulation, decision-making, or management-- those activities considered to be key or inherently governmental functions?

Every administration since 1955 has endorsed the general policy of relying on the private sector to support government operations. While this policy was designed, in part, to ensure that federal agencies do not compete with private enterprise, problems of overreliance on contractors for key functions have occurred.

One such problem was reported before this Subcommittee in March 1992 by EPA's Inspector General. EPA has contracted with Computer Sciences Corporation (CSC) since the early 1970s for technical and operational computer systems support, including a 5-year follow-on contract worth \$347 million awarded in 1990. The Inspector General noted that EPA's reliance on CSC for the development, operation, and maintenance of a majority of the agency's information and financial systems led to overdependence on contractor support and a loss of technical expertise within EPA. According to EPA's Inspector General, EPA was "in effect held hostage by contractors who have become the ones with the institutional memory." In your own words at the March 4, 1992,

hearing before this Subcommittee on EPA contract mismanagement, Mr. Chairman: "EPA allows the CSC to set its own work requirements, draft its own contracts, and review its own bills and billing. In effect, CSC appears to be contracting with itself, simply using the taxpayers' money."

The results of providing contractors broad authority with little oversight can also be seen at DOE, the only cabinet-level agency that uses contracts for most of its major missions. Over 75 percent of DOE's budget in 1991 went to 35 contractors working under 52 contracts to design, test, develop, and produce nuclear weapons; manage DOE laboratories; and conduct energy and science research. This heavy reliance on contractors with insufficient oversight has placed the government's multi-billion dollar annual investment in DOE's activities at risk. The nation will be paying many years for one of the effects of DOE's contract mismanagement--the restoration and correction of environmental, safety, and health problems at DOE's nuclear weapons complex, now estimated to cost at least \$160 billion.

Even when civilian agencies' decisions to use contractors are appropriate, agencies must ensure that contracts are awarded and administered in a cost-effective manner. This is the next issue we will highlight.

#### EFFECTIVE CONTRACT ADMINISTRATION IS NECESSARY TO CONTROL CONTRACTORS' COSTS

As mentioned earlier, the use of cost-reimbursable contracts exposes the government to the risk of overcharges and cost overruns by contractors. This places special responsibilities on civilian agencies to control costs by using good contract management and administration practices. Good contract management and administration does not begin, however, after a contract is awarded--it encompasses all activities associated with the performance of a contract, from the decision to issue a contract through contract closeout. As such, effective planning for contracting is as important as oversight of contractors' costs and performance.

Practices that agencies should follow to ensure good contract management and administration include, among others, adequate descriptions of contract work, independent government cost estimates, and effective oversight of contractors' performance and costs. Additionally, the government can further control its costs by rewarding contractors that perform well.

#### Clear Description of Contract Work

Effective contracting begins with a clear description of the services needed from the contractor. This is important if the government is to obtain what it needs at a fair price and the

contractor is to be able to determine whether it is qualified to fulfill the contract obligations and at what cost. Our previous work has shown numerous examples in which the government has had difficulty preparing clear work statements and contract clauses.

Contracts that include deficient or vague statements of work can lead to delays and increased costs. For example, the Federal Aviation Administration's (FAA) Advanced Automation System has experienced substantial cost increases and schedule delays over the last decade that are partly attributable to unrealistic scheduling of the needed contract work. FAA originally proposed this project in 1983 to replace and enhance the work stations and computer systems used by air traffic controllers at an estimated cost of \$2.5 billion and with a completion date of 1996. Since that time, the costs for the project have doubled to an estimated \$5.1 billion, and the schedule has slipped by 6 years. In large part, these cost and schedule problems have occurred because FAA substantially underestimated the effort required to develop and implement the system--another case of poor contract management and oversight.

#### Independent Government Cost Estimates

When the federal government chooses to contract for work, agencies need a clear sense of what such services should cost. Independent government cost estimates provide civilian agencies with a foundation for evaluating, negotiating, and controlling contractors' costs. Since cost-reimbursable contracts promise to pay all the contractor's allowable costs, the government and contractor must agree in advance on the limits for a project's budget. The FAR stipulates that for contracts or contract modifications expected to exceed \$25,000, the government's independent estimate should be prepared as thoroughly as if the government were submitting a proposal. Otherwise the government will be too dependent on the contractor for determining what a project should cost.

Unfortunately, civilian agencies do not always prepare independent government cost estimates. For example, EPA awards cost-reimbursable contracts to many of the contractors who study Superfund sites and oversee hazardous waste cleanups. Superfund officials agreed that it makes good sense to develop these estimates for work assignments under these contracts, which can have values well in excess of \$25,000. In 1991 we reported that regional EPA staff had developed independent estimates for only 4 of the 30 Superfund studies, with contracted values ranging from \$510,000 to almost \$3 million. In contrast, in one EPA region where cost estimates were prepared, they were effective in reducing the contractors' costs by between \$60,000 and \$1.4 million. EPA has recently required that these estimates be prepared, but now faces the challenge of developing a viable system for estimating costs and training staff to do this job.

## Contractor Performance and Cost Oversight

Once a contract is awarded, the government has another important opportunity to control costs by reviewing the contractor's performance as well as verifying the legitimacy of costs charged directly to projects. These reviews position the government to identify poor performance or overcharges by contractors. Again unfortunately, these controls are being neglected.

In 1991 we reported that program costs for removing waste from the solar evaporation ponds at DOE's Rocky Flats Plant had escalated dramatically. In fact, project costs escalated by over 40 percent from April 1990 to July 1991--from \$119 million to \$169 million. While DOE attributed the increases to such things as higher expenses for inspections and maintenance, and higher waste burial fees, we found that DOE had not effectively monitored the contractor's activities. As a result, DOE could not readily determine whether cost estimates and schedules for completing the project were reasonable.

Similarly, in July 1992 we reported that DOE and its prime contractor had not yet developed a cost and schedule control system for its \$8 billion Superconducting Super Collider Project. Without such a system, DOE is not in a position to assess the potential impact of cost and schedule changes. Even though the January 1989 contract for the project required that a system be developed as soon as possible, it may not be in place until June 1993, 4-1/2 years after DOE awarded the contract. The DOE contractor's analysis of cost trends indicates that the project may suffer a cost overrun of over \$600 million by its estimated completion date.

A second important cost control, invoice review, has also proven problematic. At EPA, for example, project managers were not consistently reviewing contract invoices, and contracting officials were not enforcing the requirements for these reviews. Instead, EPA's management has focused on timeliness and quality in achieving the agency's mission, rather than on costs. In the past few years, EPA has increased its guidance and training on invoice reviews, but many project managers say that they have still not received the training and that contractor invoices are not detailed enough to permit meaningful review.

## Incentive Payments to Reward Good Performance

Cost-reimbursable contracts often include award fees as incentive payments to reward good performance. Award fees are based on assessments of interim performance during the contract period and of overall performance at the completion of work. If used properly, assessments and incentive payments can promote high-quality work and safeguard against undeserved incentive

payments. If such payments are awarded automatically, they reduce the contractor's incentive to provide timely, high-quality work.

We found that EPA had granted interim award fees to contractors whose performance was rated as less than satisfactory at the end of the contract. Our 1988 report disclosed that 6 contractors in our sample of 11 that had received a less than satisfactory overall performance rating earned between 29 and 45 percent of the available award fees. Although EPA revised its award fee policy in June 1990 to (1) deny award fees to contractors who receive unsatisfactory performance ratings and (2) make the retention of an initial award fee contingent on satisfactory performance throughout the contract period, EPA had not modified 17 of 45 contracts as of December 1990, almost 2 years after we recommended this change.

Similarly, in our 1989 review that included six DOE award-fee determinations, the contractors' environmental performance was rated as satisfactory or better. As a result, these contractors received the majority of the available award fees even though they had been cited for repeated Resource Conservation and Recovery Act (RCRA) violations. For example, one of these contractors was cited by EPA and a state for 17 RCRA violations yet received an "excellent" rating for environmental management.

Although DOE has sought to improve its award fee determination process, it has not corrected the problem of rewarding poor performance. In 1991 we revisited this issue and criticized DOE's decision to increase the award fees to its operating contractor at Rocky Flats. The contractor received an initial rating of 76 for satisfactory performance based on a number of environmental, safety, and health weaknesses; with this rating, the contractor would not have received an award fee. Despite these weaknesses, however, DOE raised the score to 86 during the field and headquarters review process; this rating entitled the contractor to a final award fee of \$1.7 million.

#### IMPROVED CONTRACT AUDITING COULD HELP MINIMIZE FRAUD, WASTE, AND ABUSE

Audits help ensure that the government pays no more than a fair amount for the services it acquires and that the costs claimed by a contractor are reasonable, correct, allowable, and allocable. Reviews of the government's contract audit process have identified key problems that go beyond difficulties with individual agency management and contractors. Resolution of these problems depends on legal and policy changes that will affect contracts held by many civilian agencies and on the coordination and cooperation of these agencies. OMB and other civilian agencies have ongoing efforts to identify and make

recommendations to address what we believe are key problems in auditing. The OMB reports released today include recommendations to clarify audit responsibilities, reduce audit backlogs, more clearly delineate unallowable and questionable costs, and establish a government position on the use of contractor discounts, or voluntary management reductions. These initiatives are positive, but represent only a first step in helping to reduce the vulnerability of civilian agency contracts to fraud, waste, and abuse.

### Clarification of Audit Responsibilities

Clarification of which agency is responsible for auditing a contractor could improve and expedite audit coverage. Federal regulations provide that a single government agency--designated the cognizant audit agency--will assume responsibility for negotiating and establishing indirect cost rates with a given contractor.<sup>1</sup> These indirect cost rates are then binding on all other federal agencies that use the same contractor. Although cognizance is not explicitly set forth by federal regulations or OMB guidance, customarily the federal agency that has the most business with a contractor performs audits for all agencies that hold contracts with that contractor. DCAA currently provides a significant portion of the contract audit services required by civilian agencies.

In some cases, however, we found confusion and communication problems among agencies about which agency was cognizant and would perform needed audits. In 1990 testimony before this Subcommittee, we reported on audit delays in EPA contracts that resulted from (1) misunderstandings about which agency would audit a contractor in the future and (2) the time needed to set up an interagency agreement to reimburse the cognizant agency for audit services previously provided free to EPA. This Subcommittee also identified confusion about audit cognizance in its 1991 report entitled Activities of EPA's Office of Inspector General. The Subcommittee's report included a recommendation that OMB act to improve federal contract audit coverage by developing policies and procedures to clarify primary audit responsibility for contractors working for civilian agencies, including designation of primary audit responsibility for major contractors. We hope that the ongoing activities of the Contract Audit Task Force discussed in today's hearing will help clarify and resolve the issue of audit cognizance and, as a result, help expedite contract audits governmentwide.

---

<sup>1</sup>Indirect costs are costs incurred by a contractor, such as rent, utilities, advertising, and general administration expenses, that are not specifically for the benefit of an individual client's project and cannot be assigned to a specific project.

### Emphasis on Audits to Reduce Backlogs

Additional emphasis on resources for contract auditing could help reduce audit backlogs. The contracting process, especially for cost-reimbursable contracts, depends heavily on audits to ensure that the government pays no more than a reasonable amount for contracted services. If the funding and numbers of trained auditors available to perform audits are insufficient, the timing and quality of the audit reports can suffer. Although the number and dollar value of contracts issued by civilian agencies has increased dramatically since 1980, funding and staffing for audits have not kept pace. At EPA, for example, contract actions grew from \$130.8 million in fiscal year 1979 to about \$1.1 billion in fiscal year 1991, while audit resources have remained relatively constant. Within the last year, EPA has modestly increased its audit resources.

This resource shortfall has led to backlogs of uncompleted audits that increase the vulnerability of civilian contracts to potential fraud, waste, and abuse. DCAA has had backlogs of audits on contractors' incurred costs for years, in part as a result of increasing work loads during the military buildup of the 1980s, according to DCAA officials. As of September 30, 1991, DCAA had an audit backlog of approximately 13,000 incurred cost audits on contracts worth nearly \$159 billion. Similarly, we reported in October 1991 that limitations in DOE's staffing and resources have affected the agency's oversight of over \$13 billion worth of contracts to 44 integrated management and oversight contractors, delaying the audit coverage necessary to determine if costs incurred by these contractors were accurate, allowable, and reasonable. In his audit plan, DOE's Inspector General calls for audit coverage of contractors' operations at least once every 5 years. The Inspector General's operations showed, however, that, as of the third year of the 5-year audit cycle, only 384 of an estimated 2,500 needed audits had been completed. At this rate the audit cycle may take as long as 20 years to complete. While the Inspector General is requesting increases in staff, DOE estimates that these increases will only reduce the audit cycle from 20 to 16 years. As a result, DOE's Inspector General reported in his semiannual reports to the Congress that DOE's managers lack adequate assurance that their major contractors are operating economically, efficiently, and in the federal government's best interest.

In part because contracts cannot be closed out until annual audits on a contractor's incurred costs have been completed, agencies are sometimes unable to meet schedules imposed by the FAR for closing out contracts (6 months for fixed-price and 36 months for cost-reimbursable contracts). Our 1990 review of EPA audit backlogs noted that as of October 1990 EPA had almost 2,400 expired contracts worth nearly \$4.1 billion that had not yet been closed out, although some contracts had been completed as many as

19 years before that date. And, in the case of the Department of Transportation (DOT), which did not have a centralized system to track requests for DCAA audits or audit findings, we found that DOT's backlog of unfilled requests for DCAA audits grew by over 70 percent (from about 340 to about 590) between 1989 and 1992.

Delays of years before completing incurred cost audits to finalize indirect cost rates and closing out expired contracts run counter to good management. Adjustments to indirect cost rates that occur years later can, if billing rates suddenly increase, disrupt programs if funds suddenly become unavailable. Conversely, until contracts are closed, funds remain obligated. Thus, not closing contracts on time could increase the government's need to borrow and reduce the interest on funds due to the government from any contract overpayments. For example, DCAA did not conduct any incurred cost audits for one DOE contractor from 1983 to 1989. When the audits were finally conducted, they revealed overbilling of about \$1.4 million and questioned millions of dollars of unallowable costs over an 8-year period.

#### Clarifications of Unallowable and Questionable Costs

The cost implications of insufficient audits cannot be emphasized enough. Our reviews of civilian agencies' contracts and grants, as well as reviews by Inspectors General and others, have disclosed that millions of dollars in unallowable and questionable costs have been charged that do not contribute directly to the agency's intended mission. Some of these charges are explicitly unallowable and have resulted from the contractors' lack of internal controls over accounting charges or from inadequate monitoring by agency personnel. In contrast, other charges appear to result from differing interpretations of subjective areas of applicable guidance and federal regulations. In these instances, clarifications of the cost principles would make more explicit the costs that the government will pay.

The indirect cost pools in many federal civilian agency contracts we reviewed included charges that the FAR explicitly disallows. For example, we recently reviewed an EPA hazardous waste cleanup contractor whose costs included about \$7,700 for alcoholic beverages and about \$4,100 for tickets to professional basketball and football games. The FAR disallows expenditures on alcohol altogether and prohibits providing such tickets to clients. A similar DCAA review of costs charged by two other EPA contractors recently found many unallowable costs charged to government contracts, including entertainment, alcoholic beverages, dues and memberships, and losses on conference centers. Such charges can be attributed to the absence of contractor internal controls necessary to ensure segregation of unallowable expenses.

In other instances, contractors claimed costs as allowable that we believe are either questionable or unreasonable. The FAR requires that the reasonableness of indirect costs be considered in determining whether they will be allowed. In calling for application of a "prudent person" standard, the FAR does not specifically illustrate what a prudent person would consider a reasonable cost. Our reviews of DOE and EPA contractors, for example, have found numerous charges for employee parties, picnics and golf outings, including \$19,600 for entertainment, \$300 for party invitations, and \$3,200 for a dance band at a Christmas party. We question whether these kinds of expenses and the total costs are reasonable. Until cost principles--such as those relating to entertainment and employee morale and welfare--are clarified, both the contractors and the federal audit agencies will continue to have difficulty determining whether such costs are allowable. Without more specific guidance, deciding what constitutes reasonable expenditures in these areas is tantamount to navigating a minefield.

Similar problems have surfaced at universities where the federal government awards billions of dollars each year in contracts and grants for scientific research. In our August 26, 1992, report to this Subcommittee, we noted that GAO and other federal auditors had identified about \$400 million dollars in unallowable, questionable, or improperly allocated indirect costs charged to the government. These improper charges resulted from inadequate federal guidance and oversight and weak internal controls at the universities. Charges included such unallowable or questionable costs as foreign travel unrelated to research, sterling silverware and floral arrangements for the residences of university administrators, depreciation of a 72-foot luxury yacht, entertainment, and operation of a shopping center, as well as overallocations of otherwise allowable costs.

#### Voluntary Management Reductions

Clarifying the appropriate use of voluntary management reductions (VMRs) would help resolve uncertainties over government reimbursements of unallowable costs. A VMR is a percentage or dollar cost reduction a contractor voluntarily makes to its claimed costs. This reduction does not identify specific costs and is usually in addition to any identified unallowable costs. When a contractor uses a VMR, the government has the burden of either accepting the adjustment or using audits to sort out the unallowable costs. As many of these VMRs are used, they act, in essence, as a cushion to keep the contractor from being affected by any indirect costs later found to be unallowable. If unallowable costs are found after the discount has been determined, the contractor's practice is not to reimburse the government, but rather to reduce the VMR by the amount of the aggregate unallowable costs.

While we are not opposed to having contractors offer the federal government a discount, they should remove unallowable costs and account for their costs in accordance with the FAR regardless of whether they subsequently choose to offer a discount. A VMR may also encourage a contractor not to be as conscientious as necessary when making an allowability determination because the VMR pool is available to cover errors. We concur with DCAA's April 1992 conclusion that VMRs are not an acceptable alternative to effective internal controls and that contractors should install systems to identify and segregate unallowable expenses when incurred.

Mr. Chairman, the problems we have discussed here are new neither to this Subcommittee nor to the agencies themselves. The larger question to be answered is why such problems have persisted. This leads to our final point.

CULTURAL CHANGE NEEDED TO  
EMPHASIZE CONTRACT MANAGEMENT

The sustained impetus to improved contract management must result from a cultural change within agencies that places high-level emphasis on the resolution of contracting problems and long-term commitment to any corrective actions that are implemented. Simply put, it is time to stop studying the problem and to take corrective actions.

Widespread contracting deficiencies result in part from an environment within agencies that too often stresses accomplishing the mission at the expense of cost-effective contract management. The cost to the taxpayer of such practices is enormous. As mentioned earlier, the nation will be paying for many years for the results of DOE's contract mismanagement and emphasis on the production of nuclear material. DOE's cost estimate to correct environmental, safety, and health problems at DOE's nuclear weapons complex now stands at over \$160 billion.

Many of these weaknesses at civilian federal agencies have been exhaustively reported and studied in the past. In fact, a number of agencies, such as NASA, EPA, and DOE, have even acknowledged these deficiencies in internal and Federal Managers' Financial Integrity Act reports to the Congress. Despite this repeated recognition, the problems have not yet been corrected.

We believe that these problems persist, in part, because agencies have not addressed the root causes of the problems. First, only high-level management attention can elevate the importance of contract management and clearly define and delegate management accountability. The persistence of contract management problems and the inattention to contracting audits indicate a need for top agency managers to intervene, raise the level of concern throughout the agency, and see issues through to

resolution. NASA, DOE, and EPA, for example, have acknowledged significant contract management deficiencies within their agencies and have begun to take actions to establish a culture in which contractors are held more accountable for their actions and to improve agency oversight of contractors and subcontractors.

Management attention to contract management is particularly significant at DOE, where the management approach for over 40 years has been one of least interference in contractors' operations and of reimbursing contractors for virtually all costs. This management approach has led DOE to agree to special contract clauses that have diminished its authority to control contractors' costs and activities, even to the point that contractors require reimbursement for such unreasonable costs as employee thefts and contractors' fines for violating environmental laws.

To DOE's credit, it has initiated changes to hold contractors more accountable and to better direct their actions. Among other things, DOE has revised its award fee structure, is attempting to negotiate allowable cost clauses that better protect the government's interests, and is refining the statement of work clauses in contracts to increase accountability for the contractors' expenditure of funds and performance of work. The success of these actions will hinge, however, on DOE's ability to achieve a new management culture within the Department that embraces the development of an approach that balances DOE's mission to produce defense materials and protect the environment, a workplace environment that demands excellence and personal accountability, and an atmosphere that welcomes openness and constructive criticism. This same cultural change will be needed throughout the government if improved contract management on a broad scale is to be achieved.

Second, immediate and long-term commitment will help ensure effective action and follow-up. Government agencies have often established a pattern of reporting contracting deficiencies that consists of extended study of the problems, sometimes leading to revised plans and procedures, but with insufficient follow-through to get the problems corrected. For example, in response to serious deficiencies in EPA's review of contractor invoices that we identified in our 1988 report, EPA developed guidance on invoice reviews, but did not follow through by training its staff and ensuring that the invoice reviews were being done properly. As a result, when we revisited the issue last year, the problem still existed.

Third, adequate information systems are needed to assess progress and problems in contract management. Contract information systems can be used for (1) monitoring, over time, changes in the values and rates of contract cost increases and time extensions; (2) analyzing contract administration work

loads; and (3) identifying specific contracts or types of contracts for more detailed review to determine whether cost increases and time extensions were related to contract administration problems. Many agencies do not have adequate contract information systems, however. For example, we reported in September 1991 that NASA did not have a system to identify and track cost increases and time extensions in its contracts.

## CONCLUSIONS

Mr. Chairman, as you have heard from OMB and us today, government contracting problems are pervasive throughout civilian agencies and have significant financial consequences to the government. With the budget deficit and other financial commitments that the federal government faces, it cannot afford to ignore the potential cost of poor contractor oversight. For many years federal agencies have increasingly relied on contractors to carry out needed activities. Unfortunately, in all too many instances, federal agencies have abdicated to their contractors the responsibility for ensuring that contractors perform quality work cost-effectively.

Our work suggests that federal government contracting needs retooling. Agencies need to be better positioned to accurately project contract needs and effectively negotiate contracts that are both cost-effective and in the government's best interest. Agencies' internal controls--agency reviews and audits--must be strengthened to ensure that contractors are only reimbursed for quality work consistent with the contracts' provisions. Federal acquisition policies must also be clarified to ensure that only legitimate costs are passed on to the government.

Given the tens of billions of dollars that federal agencies direct to contractors and the inherently risk-laden use of cost-reimbursable contracts, federal agencies need to change their culture, emphasizing contract management and substantially increasing their accountability for and oversight of contractors' performance and costs. The work directed by your Subcommittee has played a critical role in identifying what is wrong with civilian agency contracting. It has also put in motion a number of initiatives to address these problems.

OMB's reports today contain a number of recommendations that, if implemented, would provide relief for some of the contracting problems we have highlighted. However, other OMB recommendations are more long-term in nature and will require a sustained effort on the part of the administration and civilian agencies to implement. It is critical that the new administration, as well as the new agency leadership, take ownership of these initiatives and recognize and dedicate themselves to the long-term commitment necessary to bring them to fruition.

- - - - -

Mr. Chairman, this concludes our prepared remarks. We will be pleased to respond to any questions from the Subcommittee at this time.

RELATED GAO PRODUCTSGOVERNMENTWIDE

Federal Research: System for Reimbursing Universities' Indirect Costs Should Be Evaluated (GAO/RCED-92-203, Aug. 26, 1992).

Federally Sponsored Research: Indirect Costs Charged by Selected Universities (GAO/T-RCED-92-20, Jan. 29, 1992).

Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-92-11, Nov. 18, 1991).

Federally Sponsored Research: Indirect Costs Charged By Stanford University (GAO/T-RCED-91-18, Mar. 13, 1991).

Civilian Agency Procurement: Improvements Needed in Contracting and Contract Administration (GAO/GGD-89-109, Sept. 5, 1989).

DEPARTMENT OF AGRICULTURE

Nutrition Monitoring: Mismanagement of Nutrition Survey Has Resulted in Questionable Data (GAO/RCED-91-117, July 26, 1991).

DEPARTMENT OF ENERGY

Department of Energy: Better Information Resources Management Needed to Accomplish Missions (GAO/IMTEC-92-53, Sept. 29, 1992).

DOE Management: Impediments to Environmental Restoration Management Contracting (GAO/RCED-92-244, Aug. 14, 1992).

Energy Management: Entertainment Costs Under DOE's Uranium Enrichment Production Contract (GAO/RCED-92-230FS, July 30, 1992).

Federal Research: Implementation of the Super Collider's Cost and Schedule Control System (GAO/RCED-92-242, July 21, 1992).

Nuclear Waste: Defense Waste Processing Facility--Cost, Schedule, and Technical Issues (GAO/RCED-92-183, June 17, 1992).

Nuclear Health and Safety: More Can Be Done to Better Control Environmental Restoration Costs (GAO/RCED-92-71, Apr. 20, 1992).

Energy Management: Vulnerability of DOE's Contracting to Waste, Fraud, Abuse, and Mismanagement (GAO/RCED-92-101, Apr. 10, 1992).

Federal Research: Concerns About the Superconducting Super Collider (GAO/T-RCED-92-48, Apr. 9, 1992).

Nuclear Health and Health and Safety: Increased Rating Results in Award Fee to Rocky Flats Contractor (GAO/RCED-92-162, Mar. 24, 1992).

Nuclear Waste: Weak DOE Contract Management Invited TRUPACT-II Setbacks (GAO/RCED-92-26, Jan. 14, 1992).

DOE Management: DOE Has an Opportunity to Improve Its University of California Contracts (GAO/RCED-92-75, Dec. 26, 1991).

Energy Management: Tightening Fee Process and Contractor Accountability Will Challenge DOE (GAO/RCED-92-9, Oct. 30, 1991).

Nuclear Health and Safety: Problems Continue for Rocky Flats Solar Pond Cleanup Program (GAO/RCED-92-18, Oct 17, 1991).

Energy Management: Contract Audit Problems Create the Potential for Fraud, Waste, and Abuse (GAO/RCED-92-41, Oct. 11, 1991).

Energy Management: DOE Actions to Improve Oversight of Contractors' Subcontracting Practices (GAO/RCED-92-28, Oct. 7, 1991).

Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

DOE Management: DOE Needs to Improve Oversight of Subcontracting Practices of Management and Operating Contractors (GAO/T-RCED-91-79, Aug. 1, 1991).

DOE Management: Management Problems at the Three DOE Laboratories Operated by the University of California (GAO/T-RCED-91-86, July 31, 1991).

Nuclear Nonproliferation: DOE Needs Better Controls to Identify Contractors Having Foreign Interests (GAO/RCED-91-83, Mar. 25, 1991).

Nuclear Security: DOE Oversight of Livermore's Property Management System Is Inadequate (GAO/RCED-90-122, Apr. 18, 1990).

Nuclear Health and Safety: DOE's Award Fees at Rocky Flats Do Not Adequately Reflect ES&H Problems (GAO/RCED-90-47, Oct. 23, 1989).

APPENDIX

APPENDIX

Energy Management: DOE Has Not Shown Systems Contracting to Be in Government's Best Interest (GAO/RCED-89-118, Jun. 20, 1989).

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Agent Orange Studies: Poor Contracting Practices at Centers for Disease Control Increased Costs (GAO/GGD-90-122BR, Sept. 28, 1990).

DEPARTMENT OF THE INTERIOR

Mineral Resources: Interior's Use of Oil and Gas Development Contracts (GAO/RCED-91-1, Sept. 17, 1991).

Surface Mining: Inadequate Internal Controls Cause Procurement Problems in West Virginia (GAO/RCED-89-194, Sept. 6, 1989).

Internal Controls: Bureau of Indian Affairs' Section 638 Contracts With Tribal Organizations (GAO/RCED-89-185FS, Aug. 18, 1989).

DEPARTMENT OF TRANSPORTATION

DOT Contract Oversight (GAO/RCED-93-67R, Nov. 19, 1992).

Air Traffic Control: Advanced Automation System Still Vulnerable to Cost and Schedule Problems (GAO/RCED-92-264, Sept. 18, 1992).

Highway Contracting: Disadvantaged Business Eligibility Guidance and Oversight Are Ineffective (GAO/RCED-92-148, Sept. 1, 1992).

Coast Guard: Coastal Buoy Tender Acquisition Project Did Not Follow Federal Guidelines (GAO/RCED-92-156, May 20, 1992).

Air Traffic Control: Voice Communications System Challenges Continue (GAO/IMTEC-91-49, Aug. 5, 1991).

Aviation Acquisition: Further Changes Needed in FAA's Management and Budgeting Practices (GAO/RCED-91-159, July 29, 1991).

Coast Guard: Adequacy of the Justification for Heritage Patrol Boats (GAO/RCED-91-188, July 12, 1991).

Highway Demonstration Projects: Improved Selection and Funding Controls Are Needed (GAO/RCED-91-146, May 28, 1991).

FAA Procurement: Major Data-Processing Project Is Now Ready to Proceed (GAO/IMTEC-91-32, Apr. 10, 1991).

Air Traffic Control: FAA's Advanced Automation System Contract (GAO/IMTEC-91-25, Mar. 5, 1991).

Coast Guard Acquisitions: Formal Criteria Needed to Ensure Project Manager Qualifications (GAO/RCED-90-178, June 19, 1990).

FAA Procurement: Competition for Major Data-Processing Project Was Unjustifiably Limited (GAO/IMTEC-90-71, June 11, 1990).

Air Traffic Control: Ineffective Management Plaques \$1.7-Billion Radar Program (GAO/IMTEC-90-37, May 31, 1990).

FAA Procurement: Major Data-Processing Contract Should Not Be Awarded (GAO/IMTEC-90-38, May 25, 1990).

FAA Encountering Problems in Acquiring Major Automated Systems (GAO/T-IMTEC-90-6, Apr. 18, 1990, and GAO/T-IMTEC-90-9, Apr. 26, 1990).

#### ENVIRONMENTAL PROTECTION AGENCY

Federally Sponsored Contracts: Unallowable and Questionable Indirect Costs Claimed by CH<sub>2</sub>M Hill (GAO/T-RCED-92-37, Mar. 19, 1992).

Superfund: EPA Has Not Corrected Long-Standing Contract Management Problems (GAO/RCED-92-45, Oct. 24, 1991).

EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-RCED-91-5, Dec. 11, 1990).

Hazardous Waste: Contractors Should Be Accountable for Environmental Performance (GAO/RCED-90-23, Oct. 30, 1989).

Superfund: Contractors Are Being Too Liberally Indemnified by the Government (GAO/RCED-89-160, Sept. 26, 1989).

Sound Contract Management Needed at the Environmental Protection Agency (GAO/T-RCED-89-8, Feb. 23, 1989).

Superfund Contracts: EPA's Procedures for Preventing Conflicts of Interest Need Strengthening (GAO/RCED-89-57, Feb. 17, 1989).

Superfund Contracts: EPA Needs to Control Contractor Costs (GAO/RCED-88-182, July 29, 1988).

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

Space Programs: NASA's Independent Cost Estimating Capability Needs Improvement (GAO/NSIAD-93-73, Nov. 5, 1992).

NASA Procurement: Opportunities to Improve Contract Management (GAO/T-NSIAD-92-33, May 7, 1992).

Space Station: Contract Oversight and Performance Provisions for Major Work Packages (GAO/NSIAD-92-171BR, Apr. 14, 1992).

NASA Procurement: Improving the Management of Delegated Contract Functions (GAO/NSIAD-92-75, Mar. 27, 1992).

NASA Procurement: Approach to Sharing Risk Under Certain Research and Development Contracts Is Starting to Change (GAO/T-NSIAD-92-12, Mar. 18, 1992).

NASA Procurement: Agencywide Action Needed to Improve Management of Contract Modifications (GAO/NSIAD-92-87, Mar. 2, 1992).

NASA Procurement: Management Oversight of Contract Cost and Time Changes Could Be Enhanced (GAO/NSIAD-91-259, Sept. 30, 1991).

RESOLUTION TRUST CORPORATION

Resolution Trust Corporation: Further Actions Needed to Implement Contracting Management Initiatives (GAO/GGD-92-47, Mar. 5, 1992).

Resolution Trust Corporation: A More Flexible Contracting-Out Policy Is Needed (GAO/GGD-91-136, Sept. 18, 1991).

RTC Asset Management: Contracting Controls Need to Be Strengthened (GAO/T-GGD-90-53, Sept. 24, 1990).

U.S. ARMY CORPS OF ENGINEERS

Corps of Engineers: Weak Contracting Practices (GAO/NSIAD-90-268, Sep. 7, 1990).

Water Resources: Competition for Corps of Engineers Civil Construction Contracts (GAO/RCED-88-193, Sept. 29, 1988).



---

---

### 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.

**Orders by mail:**

**U.S. General Accounting Office  
P.O. Box 6015  
Gaithersburg, MD 20884-6015**

**or visit:**

**Room 1100  
700 4th St. NW (corner of 4th and G Sts. NW)  
U.S. General Accounting Office  
Washington, DC**

**Orders may also be placed by calling (202) 512-6000  
or by using fax number (301) 258-4066.**

**Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.**

---

**United States  
General Accounting Office  
Washington, D.C. 20548-0001**

**Bulk Mail  
Postage & Fees Paid  
GAO  
Permit No. G100**

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

**Address Correction Requested**

---