

Contract Closeouts

Written by Nick Sanders

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Contract closeouts—or the lack thereof—are on the minds of many in government contracting these days. The backlog of contracts awaiting official closeout is mind-boggling on the government side. Government contracting officers are awaiting contractor action, and they are losing patience. On the contractor side, the amount of work and the lack of resources to accomplish that work is a daunting challenge.

The problem is gigantic and it's government-wide.

Despite the magnitude of the problem, everybody has an excuse for the situation. Everybody has a finger to point at somebody else.

As noted, the government points at its contractors. Prime contractors have a number of reasons for their lack of contract closeout, including (but not limited to): lack of subcontract closeouts, lack of personnel, challenges in reconciling payments made to funding ACRNs, and the general lack of paperwork to help understand the financial status of a contract that was physically completed literally years ago. With respect to those old-dog contracts, personnel turnover has not helped either the government or its contractors; often there's nobody left who has first-hand knowledge of the contractual situation. We know of at least one contract where the security certification couldn't be completed because there was literally nobody left who had the clearance to check.

All in all, it's a huge challenge that both contracting parties are moving to address, albeit in different ways.

The U.S. Government Accountability Office (GAO) recently issued a [report](#) that addresses the challenges of contract closeout across the Federal government. GAO staff reviewed the closeout status at five different Federal agencies (including DoD). A telling finding:

None of the five agencies we reviewed had all of the following: (1) centralized data on the number of contracts needed to be closed out; (2) information on where the contracts were in the closeout process; (3) established agency-wide contract closeout-related goals; and (4) established performance measures to assess progress toward achieving these goals.

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The expectation is that the agencies will follow the FAR requirements with respect to accomplishing contract closeout. As the GAO noted—

Contracts are generally considered to be physically complete once all option provisions have expired, the contractor has completed performance, and the government has accepted the final delivery of supplies or services. Physically completed contracts should then be closed within time frames set by the FAR—6 months for firm-fixed-priced contracts and 36 months for flexibly-priced contracts. The FAR prohibits the closing of contract files if the contract is in litigation, under appeal, or where the contract is being terminated and termination actions have not been completed. Flexibly-priced contracts take longer to close because additional steps must be taken during the closeout process; for example, audits on costs incurred and settlement of the contractor's final indirect cost rates.

(Footnotes omitted.)

Four of the five agencies reviewed by GAO used DCAA for contract audit support services. As readers may guess, lack of timely DCAA audit reports was cited as a cause of the inability to timely closeout flexibly priced contracts. For the period in which DCAA was prohibited from performing audit services for civilian agencies, those agencies had to find audit support elsewhere. At DHS, private auditors were put under contract. However, according to GAO, as of July, 2017, DHS had not actually issued any orders to those auditors to perform work. At the Department of State, work was issued to private audit firms and, as a result, two incurred cost reports were received. However, both State and DHS stated that they intended to stick with DCAA as their primary source of contract audit support, regardless of the lack of timely audits. According to GAO, "HHS officials stated that some of their components use DCAA for incurred cost audits, but others are using alternate options such as conducting the audit work internally or contracting out to private firms for audit support services."

GAO also noted that the civilian agencies have formed a working group to address the issue. As part of its efforts, the working group identified that the civilian agency market for contract audit services is roughly \$100 million annually. According to GAO, "the working group is preparing an ordering guide to assist agencies with placing contracts for contract audit related services. The guide, expected to be completed by August 2017, will also identify best practices to address concerns regarding the quality of audits."

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As noted, four of the five agencies in the GAO review use DCAA to perform audit services related to establishing allowable costs and final billing rates for flexibly priced contracts. GAO acknowledged that DCAA has made progress in reducing its gargantuan backlog of incurred cost audits, writing “DCAA has reduced its overall inventory of incurred cost proposals awaiting audit from about 31,000 in fiscal year 2011 to about 14,000 as of the end of fiscal year 2016. Over that same time period, DCAA reduced what it characterizes as its backlog of old incurred cost proposals—those proposals submitted for fiscal year 2013 and prior—from 21,000 to below 5,000.

However, GAO delivered some bad news in the very next sentence, writing—

DCAA did not, however, meet its original goal of having a 2-year inventory of audit proposals—eliminating its backlog of proposals older than 2 years—by fiscal year 2016 and acknowledged that meeting its revised goal to do so by the end fiscal year 2018 will be challenging. DCAA policy officials stated that they were unable to meet the goal of eliminating the backlog due to resource constraints, including workforce challenges, such as hiring freezes. Overall, as of the end of fiscal year 2016, DCAA’s total inventory included 14,208 incurred cost proposals, representing approximately \$825 billion in auditable dollar value (ADV).

GAO noted that DCAA’s “low-risk” initiative has contributed to the backlog reduction. The number of “low-risk memorandums” [*memoranda*?] issued by DCAA is significant. According to GAO, “Since the risk-based initiative was implemented in 2012, DCAA issued a total of 18,292 low-risk memorandums to close out proposals, compared to a total of 9,641 incurred cost audit reports.” In other words, for every official incurred cost audit report that DCAA has issued, it’s issued two low-risk memoranda—i.e., documentation that no audit whatsoever was conducted. DCAA justifies its lack of audits by noting that performing them on smaller final billing rate proposals is a money-loser. GAO wrote that “DCAA reported that even under its risk-based approach, it conducted 767 audits on incurred cost proposals with ADVs of \$1 million or less from fiscal years 2014 through 2016, but expended approximately \$18 million more in staff resources than the government received by identifying unallowable or questioned costs.” In other words, from a bottom-line perspective such audits should not be performed.

But DCAA is not a for-profit entity. Why is it performing such bottom-line calculations?

Another DCAA initiative is the use of multi-year audits, which DCAA asserts results in a reduction of up to 40 percent of audit staff hours. “DCAA reported that it used multi-year audits

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to close 1,232 and 1,536 incurred cost proposals, in fiscal years 2015 and 2016, respectively, which constituted about 13 percent and 19 percent, respectively, of the total number of incurred cost proposals closed in those years.” Not reported is the additional cost that contractors may incur in supporting those multi-year audits.

As readers may have guessed, GAO thinks DCAA can do better—and that if DCAA did better then that would help the contract closeout conundrum. For example, GAO wrote—

DCAA’s data for fiscal year 2016 indicate that once a contractor submits an adequate incurred cost proposal, it took DCAA on average 885 days—or nearly 2 and a half years—before DCAA completed the incurred cost proposal audit. Further, our analysis found that DCAA’s backlog of contractor proposals submitted for 2013 and prior years includes 51 adequate proposals that have \$1 billion or more in ADV submitted by at least 15 of DOD’s largest contractors for which audits have not been completed. The number of days from the date these 51 proposals were determined adequate ranged from 78 to 2,206 days at the end of fiscal year 2016, *meaning that a contractor submitted an adequate cost proposal more than 6 years ago but DCAA has not yet completed the audit*

. According to DCAA policy officials, staff availability is the primary factor for the delay before starting audit work. For example, proposals closed in fiscal year 2016 waited in DCAA’s queue an average of 747 days before the start of audit work. From the time that DCAA initiated the audit—which it defines as the date DCAA holds an entrance conference with the contractors—it took DCAA about 138 days on average to complete the audit in fiscal year 2016.

(Emphasis added; footnotes omitted.)

GAO concluded that “Assessing and implementing options to reduce the amount of time DCAA takes to begin its incurred cost audit work and establishing performance measures could help DCAA further reduce its inventory.”

GAO noted that about 10 percent of the whiskered proposals are considered to be “inadequate” by DCAA, and about 45 percent of the newer backlog is similarly considered to be “inadequate”. (We put “inadequate” in quotes because the FAR gives contractors considerably more latitude in proposal format and content than the DCAA adequacy checklist does.) GAO wrote “DCAA officials acknowledged that they do not currently have insight into the reasons why DCAA determined that a contractor’s proposal was inadequate, the number of times that a contractor submits revised proposals until it is deemed adequate, or the length of time it takes

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to receive an adequate proposal” However, DCAA reported a couple of initiatives that they thought might help contractors meet DCAA’s expectations in that area. Among the initiatives is a “web-based submission portal for incurred cost proposals that could allow contractors the option to submit their proposals with real time visibility and guidance on common issues.” (Insiders have dubbed this the “Turbo-Tax approach.”)

With respect to multi-year audits, “DCAA would like to continue the use of multi-year audits to gain work efficiencies by combining proposals under one audit. DCAA has not, however, fully evaluated how the process could be improved nor established related performance measures, such as the number of proposals closed, ADV examined, the timeliness of the audits, or its impact on contractors.”

Obviously, GAO focused its attention on Federal agencies and their contract auditors. We’d like to conclude this article by offering some tips to government contractors that might assist them in more efficiently closing-out their government contracts.

1. Start the closeout process 6 months before the expiration of the contracts’ period of performance. Do not let the PMO or the contracts team transfer away before the work is started.
2. See what efforts you can perform on an annual basis. For example, the patent certification should be an annual exercise. Can you similarly make the property certification into an annual analysis? Can you perform the payment to ACRN funding reconciliation on an annual basis?
3. Closing out subcontractors is not as hard as most people want to make it. Technically, you do NOT need official government-audited final indirect rates to closeout a subcontractor’s flexibly priced contract. (See our article on that topic [here](#).) Most of the risks that people are concerned about can be addressed with the proper certifications.
4. With respect to FPIF subcontract, the clause itself says you should not wait for final rates—though if you have them then you should use them. You could also offer an incentive to a subcontractor for prompt closeout: for example, you could offer an additional ½ point of fee if the subcontract is closed within 12 months of physical completion. (You would have to bake this into the subcontract’s terms, but it could be done.) The point is: you can do this if you focus

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on making it happen.

5. Consider where closeout efforts will be charged. Are they direct costs of the contract or are they indirect costs of the business? If you want to charge them direct, consider how that will impact your ability to close-out the contract. (Hint: you will have to apply indirect rates to those costs.)

All in all, everybody has fallen behind in contract closeouts because it was not a priority for anybody—neither on the government's side nor on the contractor's side. So now we are all faced with a mess and it will require an extraordinary effort to clean it up. But it *can* be cleaned-up, with the right management focus and a little creativity.