OFFICE OF THE INSPECTOR GENERAL

U.S. NUCLEAR REGULATORY COMMISSION

Audit of NRC's Contract Closeout Process

OIG-05-A-16 August 26, 2005

AUDIT REPORT

August 26, 2005

MEMORANDUM TO: Luis A. Reyes
Executive Director for Operations

FROM: Stephen D. Dingbaum**/RA/**
Assistant Inspector General for Audits

SUBJECT: AUDIT OF NRC'S CONTRACT CLOSEOUT PROCESS (OIG-05-A-16)

Attached is the Office of the Inspector General's audit report titled, *Audit of NRC's Contract Closeout Process*.

The audit disclosed that the Division of Contracts generally does not close expired contracts in accordance with Federal Acquisition Regulation required time standards. This delay is the result of inadequate policies and management's use of an incorrect performance metric. The audit also determined that there was approximately $6.4 million on 148 contracts awaiting closeout as of September 30, 2004, that was not deobligated within 90 days of contract expiration, as required by NRC policy. The delay in deobligating these funds caused a delay in making the funds available for other agency priorities.

If you have any questions, please call me at 415-5915 or Steven Zane at 415-5912.

Attachment: As stated

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EXECUTIVE SUMMARY

BACKGROUND

An expired contract is closed once it is both physically and administratively completed. The contract closeout process involves several administrative steps which can include, but are not limited to, settlement of subcontracts by the prime contractor; completion of a contract audit to determine final indirect and direct costs, if appropriate; payment of the final invoice; and deobligation of excess funds. The contract closeout process is subject to the requirements set forth in Federal Acquisition Regulation (FAR) 4.804, "Closeout of contract files."

PURPOSE

The objectives of this audit were to determine whether:

- The U.S. Nuclear Regulatory Commission's (NRC) contract closeout policies and procedures adhere to applicable regulations,
- Management controls associated with the closeout process are adequate, and
- NRC complies with its own closeout procedures, with an emphasis on timeliness.

RESULTS IN BRIEF

The Division of Contracts (Contracts) within the Office of Administration generally does not close expired contracts in accordance with FAR required time standards. This delay is the result of inadequate policies and management's use of an incorrect performance metric. Consequently, it becomes increasingly difficult to close long-outstanding contracts. A Contracts official represented that deobligation of funds within 90 days of expiration mitigates the effect of delayed contract closeouts. However, the audit determined that there was approximately $6.4 million on 148 contracts awaiting closeout as of September 30, 2004, that was not deobligated within 90 days of contract expiration. The delay in deobligating these funds caused a delay in making the funds available for other agency priorities.

Addressing the areas identified in this report will improve the overall efficiency of the agency's contract closeout process.

AGENCY COMMENTS

At an August 17, 2005, exit conference with agency senior executives, NRC officials agreed with the report's findings and recommendations and provided comments to clarify certain sections of the report. In response to those comments, we modified the report, as we deemed appropriate.

ABBREVIATIONS AND ACRONYMS

Contracts	Division of Contracts
DAF	Division of Accounting and Finance
EDO	Executive Director for Operations
FAR	Federal Acquisition Regulation
FTE	Full Time Equivalent
MD	Management Directive
NRC	U.S. Nuclear Regulatory Commission
OCFO	Office of Chief Financial Officer
OIG	Office of the Inspector General

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I. BACKGROUND

Contract Closeout Process

An expired contract is closed once it is both physically and administratively completed. The contract closeout process involves several administrative steps which can include, but are not limited to, settlement of subcontracts by the prime contractor; completion of a contract audit to determine final indirect and direct costs, if appropriate; payment of the final invoice; and deobligation of excess funds. The contract closeout process is subject to the requirements set forth in FAR 4.804, "Closeout of contract files."

As of September 30, 2004, NRC had 148 contracts and 41 other procurement vehicles (Grants, Cooperative Agreements, Interagency Agreements)[1] in closeout status. The total of 189 is less than the agency goal of maintaining an inventory of less than 275 contracts and other procurement vehicles awaiting closeout.

Contracts Awaiting Closeout As of September 30, 2004				
Contract Type	**No.**	**Obligated (in millions)**	**Average Time in Closeout (in years)**	**Available for Deobligation at Contract Expiration (in millions)** [2]
Fixed Price	52	$43.3	3.1	$1.5
Cost	91	219.4	5.5	4.9
Other	5	5.7	1.3	([3])
Total	**148**	**$268.4**	**4.5**	**$6.4**

The total includes 52 fixed price contracts, 91 cost type contracts, and 5 classified as "other," which are time and materials and labor hour contracts. This represents a significant improvement from the 829 contracts awaiting closeout in October 1991. Between July 29, 2003 and September 30, 2004, the agency closed 62 expired contracts.

[1] The 41 other procurement vehicles are excluded from further discussion and analysis in this report because FAR contract closeout time standards for closing out contracts do not specifically apply to them.

[2] Amount excludes holdback and final invoice for work performed prior to contract expiration, but paid after contract expiration.

[3] Actual amount of $1,700 is insignificant when converted to millions.

Contracts develops and implements agency-wide contracting policies and procedures; directs and coordinates contracting activities; and provides advice, assistance, and oversight for program activities. Contracts is comprised of a procurement policy team, a procurement oversight team, and three contract management branches. The three contract management branches perform negotiation, award, administration, and closeout of agency contracts and other functions. Currently, Contracts staff totals 32 full-time equivalents (FTE). During FY 2004, less than one FTE worked on contract closeout.

II. PURPOSE

The objectives of this audit were to determine whether:

- NRC's contract closeout policies and procedures adhere to applicable regulations,
- Management controls associated with the closeout process are adequate, and
- NRC complies with its own closeout procedures, with an emphasis on timeliness.

III. FINDINGS

Contracts generally does not close expired contracts in accordance with FAR required time standards. This delay is the result of inadequate policies and management's use of an incorrect performance metric. Consequently, it becomes increasingly difficult to close long-outstanding contracts. A Contracts official represented that deobligation of funds within 90 days of expiration mitigates the effect of delayed contract closeouts. However, the audit determined that there was approximately $6.4 million on 148 contracts awaiting closeout as of September 30, 2004, that was not deobligated within 90 days of contract expiration. The delay in deobligating these funds caused a delay in making the funds available for other agency priorities.

A. Noncompliance With FAR Time Standards

As of September 30, 2004, approximately 77 percent of the agency's expired contracts had not been closed in accordance with FAR required time standards that vary by contract type. Twenty-five of the expired contracts have been awaiting closeout for more than 5 years beyond the time standards specified by FAR. This delay is caused by:

- Inadequate Contracts policy, and
- Management's use of an incorrect performance metric.

Consequently, it becomes increasingly difficult to close long-outstanding contracts. For example, 5 years after a contract has expired: (i) many companies and the NRC will have experienced a loss of institutional memory, (ii) contract files and supporting documentation can be difficult to locate, and (iii) the contractor may go out of business or be acquired by another firm.

Federal Acquisition Regulation Requirements

The contract closeout process is subject to the requirements set forth in FAR 4.804-1. These requirements include time standards that vary by contract type.

- Firm-fixed-price contracts, other than those using simplified acquisition procedures, should be closed within 6 months after evidence is received of physical completion.

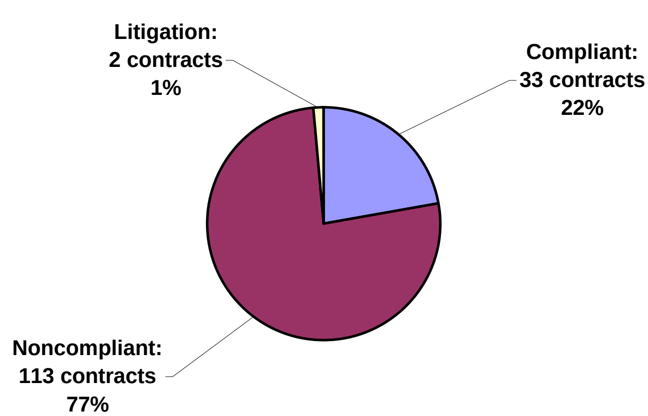
- Cost type contracts that require settlement of indirect cost rates should be closed within 36 months of the month in which the contracting officer receives evidence of physical completion.

- Other contracts, including time and materials and labor hour, should be closed within 20 months of the month in which the contracting officer receives evidence of physical completion.

Noncompliance With Federal Acquisition Regulation Requirements

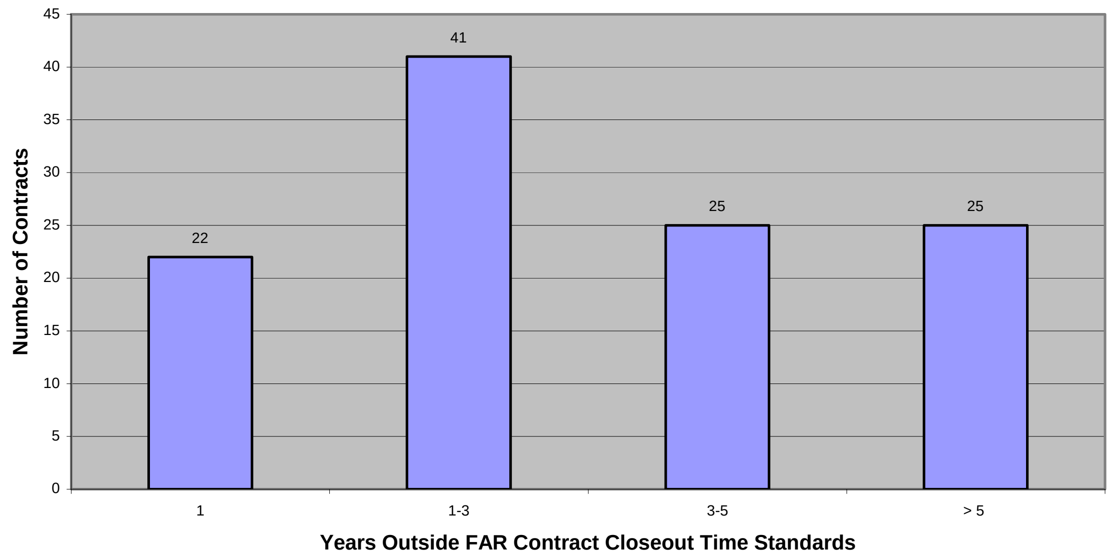
In general, the agency is not in compliance with FAR.804-1. As of September 30, 2004, 113 of 148 contracts in closeout status (approximately 77 percent) were not in compliance with the FAR contract closeout time standards. Analysis of the Contract Closeout Inventory Report showed that 50 of 52 fixed price contracts and 63 of 91 cost type contracts examined were not in compliance with the FAR contract closeout time standards. The analysis also showed that 33 contracts (1 fixed price, 27 cost type and the 5 "other" which includes time and materials and labor hour) were compliant with the FAR contract closeout time standards. The following chart presents the combined results of the analysis:

Adherence to FAR 4.804-1



Additionally, an aging of the contracts that are in noncompliance with FAR 4.804-1 demonstrated that, for fixed price contracts, 6 of the noncompliant contracts were more than 5 years beyond the time standards specified by FAR as were 19 of the cost contracts. The contracts were aged separately according to type and then aggregated by the number of years past their respective FAR contract closeout time standards. The chart below presents the combined results of the contract aging.

Aging of Noncompliance with FAR 4.804-1



Factors Causing Delays in Closing Contracts

Delays in closing out agency contracts are the result of inadequate policy, management's use of an incorrect performance metric, and management priorities.

Inadequate Contracts Policy

Contracts' policies do not specifically include reference to the FAR contract closeout time standards. Neither Management Directive (MD) 11.1, "NRC Acquisition of Supplies and Services" nor Contracts' internal contract closeout policy, which is unsigned and undated, address compliance with the FAR contract closeout time standards for closing out contracts.

Management's Use of an Incorrect Performance Metric

Management focuses on one performance metric that does not address FAR compliance. The current goal is to maintain the closeout inventory below 275 contracts and other procurement vehicles. The goal of one number that includes all procurement vehicles in closeout status dates back to about October 1991 when the agency faced a backlog of 829 expired but not closed contracts and other procurement vehicles. However, concentration on such a broad goal does not account for the potential situation where the closeout inventory may exceed a given number, but none of the contracts are outside the FAR contract closeout time standards. The issue is not the number of procurement vehicles in closeout status, but rather compliance with FAR contract closeout time standards.

Management Priorities

Contracts management does not consider the contract closeout process a priority, as other activities, particularly contract awards, are considered more pressing. During FY 2004, less than one FTE worked on contract closeouts. Management expressed hope that the success of recent efforts to hire additional staff will ease the staffing shortages and enable them to devote more resources to contract closeout.

Difficulties in Closing Long-Outstanding Contracts

The longer the time between contract expiration and closeout the more difficult it becomes to complete the process. In particular, the loss of institutional memory with turnover in both contractor and Contracts personnel adds to the difficulty in closing old contracts. Contract files may become more difficult to locate. Finally, contractors may go out of business or be taken over by other contractors, making closeout extremely difficult.

RECOMMENDATIONS

OIG recommends that the Executive Director for Operations (EDO):

1. Revise MD 11.1 and the internal contract closeout policy to include FAR contract closeout time standards.

2. Implement, sign, and date the internal contract closeout policy.

3. Revise the performance metric to address compliance with FAR contract closeout time standards.

B. Deobligations Not Timely

Funds totaling at least $6.4 million have not been deobligated within 90 days of contract expiration as required by Contracts' policy. Specifically, for 83 percent of the contracts awaiting closeout as of September 30, 2004, Contracts has taken an average of 322 days to reach the first step in the deobligation process. Management's inadequate monitoring of the process results in substantial delays in NRC's ability to use such funds for other agency priorities.

Policy

Contracts' policy regarding deobligation of funds remaining on expired contracts is set forth in Part 11 of MD 11.1, "NRC Acquisition of Supplies and Services." MD 11.1 specifies that the contract specialist is to perform all actions to administratively close out contracts, *including deobligation of any excess funds within 90 days of contract expiration*. (Emphasis added.) Additionally, Contracts' internal policy states that modifications deobligating excess funds should be completed within 90 calendar days from the date of contract/task order expiration. The internal policy further states that the contract specialist must complete the form (known as the DAF form)[4] that initiates the closeout process within 30 days of contract expiration. Finally, Contracts' policy provides that the deobligation of excess funds shall be given the "highest absolute priority."

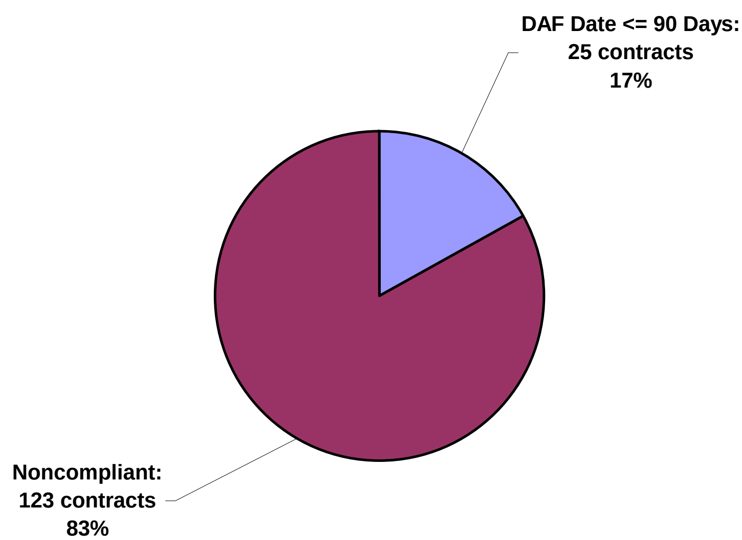
Deobligation Time Significantly Exceeds Agency Policy

Contracts is not in compliance with MD 11.1 and its internal closeout policy for deobligation of excess funds. Specifically, for 123 of 148 contracts in closeout status (83 percent) as of September 30, 2004, Contracts did not deobligate excess funds within 90 days of contract expiration. Because of data limitations, the actual date of deobligation of excess funds was not readily available. However, an analysis of the Contract Closeout Inventory

[4] The DAF, or Division of Accounting and Finance, form is used to notify the Division of Financial Services, formerly the Division of Accounting and Finance, in the Office of the Chief Financial Officer, of the amount to be deobligated on an expired contract. If the amount is $300 or less, the DAF form provides for administrative deobligation of the funds. For amounts greater than $300, the DAF form serves as notice that a deobligation modification will be submitted.

Report showed that the average elapsed days to complete the first step of the deobligation process was 322 days, which far exceeds the 90-day requirement to complete the entire deobligation process[5]. For the remaining 25 contracts, the elapsed days between the expiration date and the DAF date (the first step in the deobligation process) is less than 90 days. There is no assurance, however, that the deobligation was executed within the 90-day requirement. The following chart demonstrates the degree of compliance with Contracts' policy.

Adherence to 90 Day Deobligation Policy

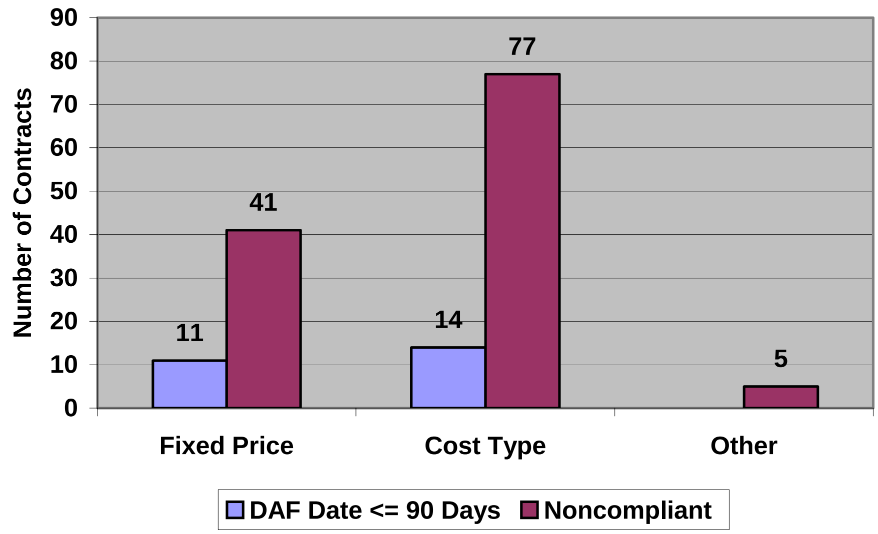


[5] The 322 days to complete the first step was calculated by comparing the contract expiration dates and the DAF dates included in the Contract Closeout Inventory Report. Contracts management said that the DAF Date on the Contract Closeout Inventory Report represents the date the contract specialist fills out the DAF form and is the first step in the deobligation process.

Breakdown by contract type

As shown in the following chart, further analysis of the Contract Closeout Inventory Report revealed that the agency exceeded the 90-day deobligation requirement on 41 of 52 fixed price contracts, 77 of 91 cost type contracts, and 5 of 5 "other" contracts.

Compliance with 90 Day Deobligation Policy



Inadequate Monitoring

Inadequate monitoring of the process causes delays in deobligation of excess funds remaining on expired contracts. Contracts' management does not have an established process for monitoring compliance with the 90-day deobligation requirement. Each quarter, on an informal basis, a contract specialist on the Procurement Policy Team tries to remind contract specialists of contracts that need deobligation forms completed. However, other priorities may intervene and such notification does not always occur.

Substantial Delays in Using Funds for Other Agency Purposes

Approximately $6.4 million was not deobligated within 90 days of contract expiration, based on an analysis of the funds associated with 123 of the 148 contracts listed on the September 30, 2004, Contract Closeout Inventory Report. Contracts Management inadequately monitors the deobligation process, resulting in substantial delays in the NRC's ability to use such funds for other agency priorities. In addition, NRC's failure to deobligate funds timely increases the agency's vulnerability to fraud.

RECOMMENDATION

OIG recommends that the EDO:

4. Develop and implement a process to monitor compliance with agency deobligation policy.

IV. CONSOLIDATED LIST OF RECOMMENDATIONS

OIG recommends that the EDO:

1. Revise MD 11.1 and the internal contract closeout policy to include FAR contract closeout time standards.

2. Implement, sign, and date the internal contract closeout policy.

3. Revise the performance metric to address compliance with FAR contract closeout time standards.

4. Develop and implement a process to monitor compliance with agency deobligation policy.

Appendix A

SCOPE AND METHODOLOGY

To accomplish the audit objectives, the OIG reviewed and analyzed pertinent laws, regulations, authoritative guidance and a prior relevant OIG report. In addition, OIG analyzed and compared NRC's guidance with the FAR. OIG conducted interviews with selected NRC officials to:

- Gain an understanding of the agency's contract closeout/deobligation process;
- Determine current issues, problems, known deficiencies; and
- Assess management controls.

For benchmarking purposes, OIG contacted the Chief Acquisition Officers Council and the U.S. Agency for International Development to obtain information about contract closeout/deobligation best practices.

OIG examined 148 contracts listed on Contracts' Contract Closeout Inventory Report as of September 30, 2004. Using data from the reports, the auditors performed tests of compliance with the FAR and NRC acquisition requirements and analyzed the aging of contracts in closeout status.

OIG conducted this audit in accordance with Generally Accepted Government Auditing Standards from September 2004 through June 2005.

The major contributors to this report were Steven Zane, Team Leader; Kathleen Stetson, Audit Manager; and Steven Shea, Senior Auditor.