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**SYSTEMIC DELAY IN DEFENSE CONTRACTING:  
A CASE STUDY OF THE DEFENSE CONTRACT  
MANAGEMENT AGENCY'S CONTRACT  
CLOSEOUT BACKLOG FROM FY2015 TO FY2020**

Rawls, Darius D.; Stone, Arthur L., Jr.; Woods, Justin B.

Monterey, CA; Naval Postgraduate School

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# NAVAL POSTGRADUATE SCHOOL

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MBA PROFESSIONAL PROJECT

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## SYSTEMIC DELAY IN DEFENSE CONTRACTING: A CASE STUDY OF THE DEFENSE CONTRACT MANAGEMENT AGENCY'S CONTRACT CLOSEOUT BACKLOG FROM FY2015 TO FY2020

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December 2023

**By:** Darius D. Rawls  
Arthur L. Stone Jr.  
Justin B. Woods

**Advisor:** Brett M. Schwartz  
**Co-Advisor:** Simona L. Tick

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BACKLOG FROM FY2015 TO FY2020**

Darius D. Rawls, Lieutenant Commander, United States Navy  
Arthur L. Stone Jr., Lieutenant Commander, United States Navy  
Justin B. Woods, Lieutenant, United States Navy

Submitted in partial fulfillment of the  
requirements for the degree of

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from the

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December 2023**

Approved by: Brett M. Schwartz  
Advisor

Simona L. Tick  
Co-Advisor

Rene G. Rendon  
Academic Associate  
Department of Defense Management

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In this study, we analyze the Defense Contract Management Agency's (DCMA) actions, from FY2015 to FY2020, to reduce a backlog of more than 72,000 overage flexibly priced contracts (FPC) that awaited administrative closeout. By working directly with the Defense Contract Audit Agency (DCAA) to align organizational priorities and deconflict internal procedures, the DCMA identified systemic delays in its closeout process and reduced the FPC backlog. Using historical data generated during the DCMA's Material Weakness Initiative (MWI), our analysis focuses on the DCMA's overall effectiveness in closing FPCs. The goal of our research is to provide defense contracting activities a roadmap to prevent future backlogs and reduce current backlogs. One main takeaway is the importance of aligning organizational priorities and deconflicting internal procedures between interconnected contract administration participants to close FPCs on time and efficiently. Three primary recommendations that stem from our findings are that defense contracting organizations should: (1) set organizational FPC closeout goals and use metrics to track closeout progress, (2) when multiple entities are involved, establish a process to track queued FPCs awaiting administrative action by all organizations, and (3) consider adding contract clauses that enable administrative contracting officers to efficiently close FPCs during the post-award phase. Additional recommendations for further research are also provided.



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## LIST OF ACRONYMS AND ABBREVIATIONS

ACO	Administrative Contracting Officer
ADV	Auditable Dollar Value
AFCAP	Air Force Contract Augmentation Program
CAM	Contract Audit Manual
CAO	Contract Administration Office
CCC	Contract Closeout Centers
CLMC	Contract Life cycle Management Center
CMC	Contract Management Center
CMO	Contract Management Office
CPFF	Cost Plus Fixed Fee
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DCMC	Defense Contract Management Command
DCMDM	Defense Contract Management District Mid-Atlantic
DDPC	Director of Defense Pricing and Contracting
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
DPAP	Defense Procurement and Acquisition Policy
FAO	Field Administration Office
FAR	Federal Acquisition Regulations
FFP	Firm-Fixed Price
FPC	Flexibly Priced Contract
FPRP	Forward Pricing Rate Proposals
FY	Fiscal Year
GAO	Government Accountability Office
ICP	Incurred Cost Proposal
IG DOD	Inspector General, Department of Defense

LCAP	Logistics Civil Augmentation Program
LRM	Low-Risk Memorandums
LRQCO	Low-Risk Quick Closeout
MOCAS	Mechanization of Contract Administration System
MWI	Material Weakness Initiative
NCMA	National Contract Management Association
OCONUS	Outside Continental United States
PCIE	President’s Council of Integrity and Efficiency
PROCAS	Process Oriented Contract Administration Services
QCO	Quick Closeout
SPAWAR	Space and Naval Warfare Systems Command
ULO	Unliquidated Obligation

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\*\*\*

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**Arthur L. "AJ" Stone Jr., LCDR, SC, USN:** Christ (Yeshuah) is the one through whom we can all access God by faith. I encourage anyone who finds faith a futile endeavor to seek the divine evidence of God's hand in their life (Matthew 7:7).

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# I. INTRODUCTION

## A. BACKGROUND

Government contracting activities routinely experience backlogs of contracts that are physically complete and awaiting administrative closeout. As a result, closeout backlogs cause contracts to become overage, funds to be canceled, and the current funds to be inefficiently re-allocated to pay debts incurred by the government during prior fiscal years. “A contract is considered physically complete when the contractor has completed performance and the government has inspected and accepted all supplies and services” (Defense Contract Management Agency [DCMA], 2019, p. 11). Additionally, “contracts are considered overage when they remain open beyond the FAR standard timeframes” (DCMA, 2019, p. 12). Due to the nature of government contracting and the multiple participant organizations involved in contract administration, the contract closeout process often experiences systemic delay caused by misaligned organizational priorities and conflicting internal procedures between the involved organizations; these elements culminate in eventual closeout backlogs. We analyze this phenomenon in a case that occurred at the Defense Contract Management Agency (DCMA). More specifically, we analyze factors surrounding the organization’s Material Weakness Initiative (MWI) from fiscal years (FY) 2015 to 2020 and how this cultural shift ushered in the DCMA’s reduction of a years-old backlog of overage contracts awaiting closeout to acceptable levels.

Government contracting activities involved in the administration of flexibly priced contracts (FPCs) may have conflicting organizational priorities. In the context of this case, the DCMA’s ability to close FPCs is dependent on the Defense Contract Audit Agency’s (DCAA) incurred cost proposal (ICP) audit throughput. However, in FY2011, the DCAA reported that ICP audits were not assigned high priority due to the fact that they did not provide as much return on investment as forward pricing audits (DiNapoli et al., 2012). The DCAA’s mission is to audit contractor proposals and invoices for Department of Defense (DOD) components. The organization’s responsibilities include performing audits of contractor ICPs to ensure all presented costs are “allowable, allocable, and reasonable—information that contracting offices need to close FPCs” (DiNapoli et al., 2012, p. 7).



Contract closeout impediments are further exacerbated when contracting participants have internal procedures that conflict with one another and further delay the closeout process. According to Ruffing (2022), before 2012, the DCAA's Contract Audit Manual (CAM) set a \$15 million auditable dollar value (ADV) threshold that classified ICPs as high risk and mandated review by a DCAA auditor before final payment to the contractor. Due to the large quantity of ICPs that met the ADV threshold for classification as high risk, FPCs awaiting DCAA auditor review overwhelmed the organization's capacity, and a backlog of ICP audits mounted in the DCAA's queue.

Defense contracting activities continue to experience backlogs of overage FPCs that are physically completed and awaiting administrative closeout. Achievements during the DCMA's MWI involved realigning organizational priorities and deconflicting internal procedures between the DCMA and the DCAA to mitigate the systemic delay of backlogged overage FPCs awaiting closeout.

## **B. PURPOSE OF RESEARCH**

The body of literature about federal contract closeout indicates that contracting organizations tend to assign a low priority to contract closeout. Additionally, since contract closeout frequently involves more than one organization, it is imperative to consider how the organizational priorities and internal procedures of the involved participants influence contract closeout effectiveness.

We aim to present the DCMA's case in a manner that highlights the importance of aligning organizational priorities and deconflicting internal procedures between interconnected contract administration participants to close FPCs on time. By providing evidence-based findings, we also aim to offer actionable recommendations that will assist government contracting activities to optimize resource utilization and prevent backlogs of FPCs that await administrative closeout.

## **C. RESEARCH QUESTIONS**

The research questions for our study include the following:

1. What steps did DCMA take to reduce the backlog of overage FPCs awaiting administrative closeout?
2. How effective were the DCMA's processes at returning the contract closeout backlog to an acceptable level?
3. What practices enable defense contracting organizations to reduce and prevent FPC backlogs?

## **D. METHODOLOGY**

Using the case study approach, we investigate the DCMA's contract closeout actions from fiscal year FY2015 to FY2020 to reduce a peak backlog of 72,000 overage contracts, 98% of which were FPCs (Defense Contract Management Agency [DCMA], n.d.). For this research project, we primarily collect data from government reports, memorandums, and literature available through online academic databases. We are fortunate to be given access to historical contract closeout data from the Contract Life Cycle Management Center, the DCMA's premier center of excellence in contract closeout and contract termination settlement (DCMA, n.d.b). Our research approach did not require human subject observations, or individual interviews, during the project.

### **1. Case Study Approach Rationale**

The case study method is distinguished as a primary research strategy when there's a need to deeply comprehend complex real-life phenomena within their native context (Yin, 2009). It is this characteristic of case studies that facilitates a thorough examination of issues, especially those underlined by a multitude of interconnected variables. Hancock and Algozzine (2006) assert that this method is useful particularly when the aim is to untangle the "how" and "why" of specific phenomena, more so when the demarcations between the phenomena and their context blur. This very scenario is evident in our exploration of defense contract closeout, where the associated FPC backlogs and the dynamics between interacting organizational priorities and procedures of two key players in defense contracting—the DCMA and DCAA—are presented.

Drawing from these strengths of the case study method, our research examines the challenges the DCMA faces in closing FPCs. By adopting this approach, we are better positioned to identify themes and details inherent in the FPC closeout process. Hancock and Algozzine (2006) emphasize that the method's versatility to harness data from multiple sources enriches the research's validity and depth. Our holistic approach to data collection and analysis, which blends organizational data and literature from the body of knowledge, aims to capture the complex nature of the DCMA's FPC backlog issue.

The case study approach, as Hancock and Algozzine (2006) contend, provides not only rich descriptions of the issue at hand but also strategies that can be generalized to other contracting settings, making it an invaluable tool in the context of our study. By scrutinizing the operational synergy between the DCMA and the DCAA through the case study approach, our study aims to provide evidence-based recommendations that defense contracting organizations can use to reduce and prevent contract closeout backlogs.

## **2. DCMA's Material Weakness Initiative**

The DCMA's MWI is the internal program through which the DCMA identifies the root causes of its FPC backlog. The MWI serves as a fundamental cornerstone in our research. Careful examination of available data from the MWI enables us to explore how organizational priorities and internal procedures, between the DCMA and the DCAA, contribute to the emergence of a systemic delay in the FPC closeout process. Analyzing the DCMA's closeout data from FY2015 to FY2020 along with the available literature provides a glimpse into the factors that influence the DCMA's FPC closeout process.

## **3. DCAA's Influence on the Contract Closeout Process**

The DCAA plays a critical role in the timely and effective closeout of federal contracts, particularly in the context of ICP audits for defense contracting organizations. Our research aims to reveal the influence of the DCAA's procedures on the FPC closeout process. We explore how the DCAA's audit procedures intersect with the broader landscape of defense contracting to impact the timely closeout of FPCs. By examining instances of delayed ICP audits, we endeavor to reveal how these delays create bottlenecks in the FPC closeout process.

By understanding how the DCAA's organizational priorities and internal procedures contribute to the DCMA's FPC closeout backlog, our research intends to shed light on how changes to both organizations' priorities and procedures work in concert to reduce the DCMA's FPC closeout backlog to acceptable levels.

#### **4. Research Approach Steps**

Our study begins with an introduction to federal contracting and contract closeout backlogs. Next, we review the available literature to understand what methods have been employed over the past 30 years to reduce contract closeout backlogs. In keeping with the case study framework, we focus the study on two key players in the defense contract closeout process—the DCMA and the DCAA. These two DOD entities play large contract administration roles in the federal government. Both are introduced and described to provide an understanding of the defense contracting landscape. Our analysis consists of two steps: first, we examine the actions both organizations take to update strategic priorities and internal procedures; second, we assess the impact of these actions on reducing the DCMA's FPC backlog and draw conclusions based on our findings. Finally, we provide recommendations based on the conclusions.

The first step of the analysis involves identifying the organizational priorities of both the DCMA and the DCAA. In this step, we investigate how both organizations identify weaknesses in their organizational priorities that prolong the defense contract closeout process. Next, we examine the cultural changes both organizations implement to elevate contract closeout to a position of strategic importance. The intent behind this step is to illuminate how divergent business goals across different stakeholder organizations hinder the FPC closeout process.

In the second step, we shift the research focus to the internal procedures involved between both organizations to close FPCs. Emphasis is given to updates in the DCAA's ICP audit process and its substantial influence in the DCMA's FPC closeout backlog. By reviewing literature about contract closeout backlogs resulting from delayed ICP audits and analyzing class deviation memorandums, reports, and manuals from both agencies, we identify procedural updates carried out by both organizations that enable the DCMA to

more rapidly close FPCs. The true value of this step lies in how it reveals procedural conflicts that exist between both organizations and which exacerbate the DCMA's FPC closeout backlog.

By analyzing how the interplay between misaligned organizational priorities and conflicting procedures create a systemic delay in the DCMA's FPC closeout process, we set out to provide actionable recommendations for defense contracting organizations.

## **E. LIMITATIONS OF RESEARCH**

Even though various other government agencies may be involved in the defense contract closeout process, our study is limited in scope to contract closeout issues that occurred between the DCAA and the DCMA due to the large quantity and dollar value of FPCs managed by the DCMA. The purpose of this study is limited to helping defense contracting organizations identify feasible alternative methods to improve timeliness in completing administrative closeout actions for FPCs that are physically completed. Based on the limitations of our research scope, a list of recommendations for further research is presented in Chapter VI.

## **F. IMPORTANCE OF RESEARCH**

In defense contracting, multiple organizations are involved—each with its own organizational priorities and internal procedures—throughout the life cycle of FPCs. When organizational priorities and internal procedures conflict, systemic delays ensue and encumber the contract closeout process; this leads to closeout backlogs.

### **1. Organizational Priorities**

The DCMA and the DCAA are two critical agencies within the DOD that have individual responsibilities for interconnected steps in the contract closeout process. While the DCMA primarily focuses on contract administration, the DCAA specializes in auditing defense contractors to ensure they comply with federal regulations and deliver value to the government. Cooperation between these two agencies is paramount. Through our research, we present how both agencies adjusted their organizational priorities. These changes facilitated smoother operations that allowed both agencies to fulfill their original missions

with reduced bureaucratic complexities. By examining these modifications, we encourage defense contracting teams to assess their organizational priorities for necessary changes that promote higher efficiency in FPC closeout.

## **2. Internal Procedures**

The case study also includes an investigation of the equally important role conflicting internal procedures played between the DCMA and the DCAA. By peeling the layers of both organizations' internal procedures, we are determined to uncover points of friction that further exacerbated the systemic delay of overage FPCs that awaited administrative closeout. In identifying these points of friction, we seek to propose recommendations that improved internal procedures and streamline the FPC closeout process.

## **3. Systemic Delays**

Within the context of our research, systemic delays in contract closeout are disruptions that hinder the efficient flow of tasks and cause bottlenecks in the FPC closeout process. Consequently, these delays obstruct the timely and efficient utilization of funds and undermine the overall effectiveness of defense contracting. At the heart of systemic delays lies a network of interdependent organizations that comprise government contract management. The closeout phase is the final link that connects them in the contract management chain. At this stage of the contracting life cycle, delays can significantly reduce the government's ability to responsibly manage appropriated tax dollars.

## **G. ORGANIZATION OF REPORT**

Our report consists of six chapters to explore the challenges surrounding the DCMA's FPC closeout process. This chapter introduces the background, purpose, research questions, methodology, limitations, importance of the research, and the organization of the research report. Chapter II provides an overview of federal contracting and the contract closeout process, then presents relevant literature from the past three decades which reveal important nuances in the FPC closeout process. Chapter III profiles the primary entities in our case study: the DCMA and DCAA. Chapter IV presents our analysis of the

organizational priorities and internal procedures that are influential during the DCMA's MWI, using internal reports, charts, memorandums, and manuals from both the DCMA and the DCAA. Chapter V presents a discussion of our case study's findings and conclusions. Chapter VI presents recommendations based on our findings, and recommendations for future research.

## **H. SUMMARY**

This chapter provides an introduction and overview of our case study. We present relevant background information to explain the significance of contract closeout challenges in defense contracting, specifically focusing on organizational priorities, internal procedures, and how they converge to create systemic delays in the FPC closeout process. We then articulate the purpose of the research, emphasizing an examination of the DCMA's establishment of the MWI from FY2015 to FY2020 to reduce a backlog of overage FPCs. We present three research questions to guide our inquiry. The methodology section describes the case study research approach and its relevance in studying the DCMA's FPC backlog. We present limitations of the research with an emphasis on limiting the research scope to analysis of the DCMA and the DCAA, and we emphasize that the importance of our research is to enhance fiscal responsibility, streamline the FPC closeout process, and contribute to systemic improvements in defense FPC closeout practices.

The following chapter describes federal contracting and the phases of the contract life cycle, contract administration and the contract closeout process, how shareholder risk is influenced by the selected contract type, and provides examples from the literature of historical efforts to reduce contract closeout backlogs.

## **II. FEDERAL CONTRACTING, CONTRACT CLOSEOUT, AND CLOSEOUT BACKLOGS**

### **A. INTRODUCTION**

This chapter describes federal contracting and the phases of the contract life cycle, contract administration and the contract closeout process, how shareholder risk is dependent on the selected contract type, and then provides examples from the literature of previous efforts by government contracting organizations to reduce contract closeout backlogs.

### **B. FEDERAL CONTRACTING AND THE CONTRACT LIFE CYCLE**

In FY2022, the U.S. government obligated \$694.2 billion through contracts (Government Accountability Office [GAO], 2023), as indicated in Figure 1. This substantial financial commitment highlights the critical role that federal contracting plays in the operations of government agencies and the delivery of goods and services. The largest single purchaser of goods and services in the world is the federal government, and it utilizes contracts to fulfill its wide range of responsibilities (GAO, 2023). Consequently, federal contracting is a complex process governed by a web of laws, regulations, and procedures that connect federal governmental requirements with services and products offered by the civilian industry. This government and private sector collaboration is vital for delivering essential services, supporting economic growth, and ensuring national security.



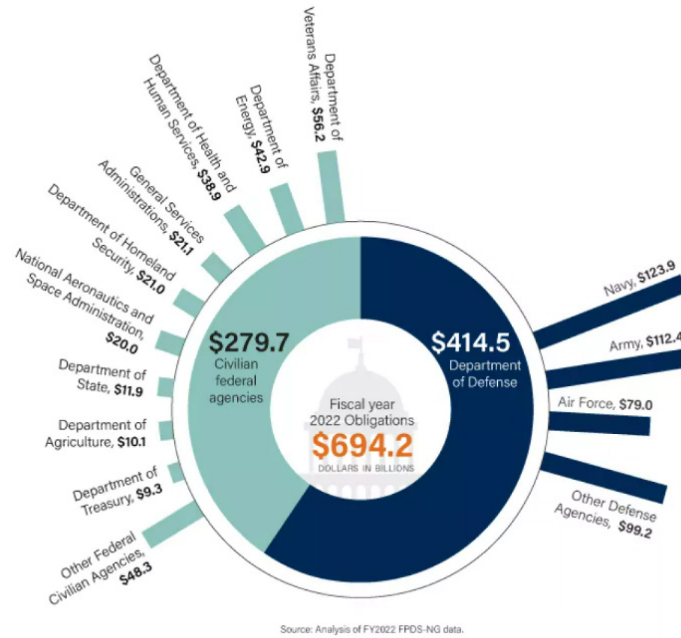


Figure 1. FY2022 Contractual Obligations. Source: GAO (2023).

In our study, we present the National Contract Management Association’s (NCMA) simplified contract life cycle framework (see Figure 2) which divides the government contracting process into three life-cycle phases: pre-award, award, and post-award (National Contract Management Association [NCMA], 2023). These phases represent critical stages in the life cycle of a government contract, with each characterized by distinct activities, objectives, and challenges.

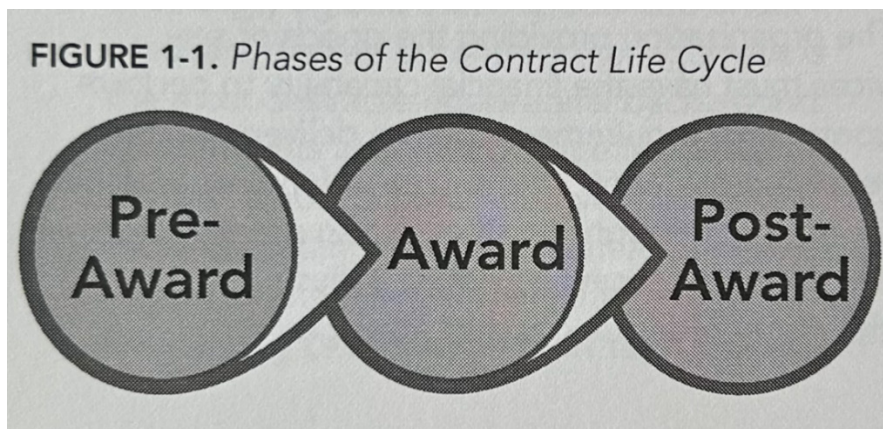


Figure 2. NCMA Phases of the Contract Life Cycle. Source: NCMA (2023).

The pre-award phase marks the initial phase of the contracting life cycle. During this phase, government agencies identify their needs, develop an acquisition strategy, and solicit proposals or bids from potential contractors. Key activities include defining requirements, conducting market research, and drafting solicitations (NCMA, 2023). In this phase, the federal government aims to establish a clear understanding of project requirements, assess vendor capabilities, and ensure competition and transparency in the procurement process. Effective pre-award planning and execution lay the foundation for the subsequent phases and are critical for achieving successful contract outcomes.

Following pre-award activities, the award phase encompasses all the efforts by both the buyer and seller that result in the creation of an awarded contract (NCMA, 2023). Following the selection of a contractor during the source selection process, the contract life cycle moves into the award phase, which comprises contract negotiations, finalization, and performance by the contractor. This phase transitions the contracting life cycle from the planning and proposal evaluation stages to actual acceptance of terms and contractor performance of the parameters within the contract during the post-award phase.

The post-award phase, often considered the most extensive, begins after the contract is awarded and extends throughout the remainder of the contract's life cycle. This phase includes contract administration, contractor performance monitoring, and contract closeout (NCMA, 2023). Effective post-award management ensures that contractual obligations are met, funds are allocated appropriately, and contractor performance is effectively evaluated. Among these post-award activities, contract closeout is particularly interesting in this research as it involves the final administrative actions required to formally conclude a contract, reconcile financial transactions, and ensure compliance with federal regulations. The post-award phase is especially important because its delay or mismanagement can lead to monetary loss, reduced operational capability of military units, and systemic delays in the federal contracting process.

Our research focuses on the post-award phase and, more specifically, defense contract closeout. The significance of contract closeout lies in its potential to prevent monetary loss, enhance organizational efficiency at contract management offices (CMOs) during contract administration, and prevent or eliminate systemic delay in the defense

contracting process. The literature review section in this chapter presents some contract closeout challenges federal contracting organizations face and measures taken to improve closeout efficiency.

### C. THE CONTRACT CLOSEOUT PROCESS

The final administrative action in each DOD acquisition is contract closeout. It confirms that both parties have completely fulfilled their obligations to each other (Department of Defense [DOD], 2019). The complexity of the contract closeout process can vary depending on the contract type, such as firm-fixed-price or cost-reimbursement. Figure 3 demonstrates how contract types range from FFP, where the contractor assumes “most of the risk for costs and profit/loss, to cost-plus-fixed-fee (CPFF), which is a cost-reimbursement contract type where the contractor has minimal responsibility for costs and receives a predetermined fixed fee” (Ruffing, 2022, p. 12). Choosing the contract type involves negotiation with the contractor and demands a prudent assessment by the contracting office.

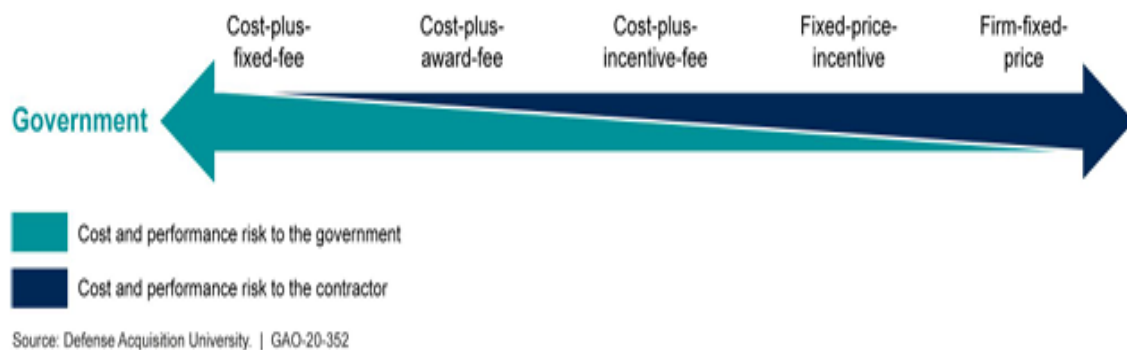


Figure 3. Spectrum of Contract Types and Risk. Source: Oakley (2020).

Once a contract is physically complete, administrative closeout comprises 15 meticulous steps and procedures outlined in Federal Acquisition Regulation (FAR) 4.804-5 to settle the contractual relationship, finalize financial transactions, and ensure

compliance with the FAR. The administrative closeout procedures outlined in the FAR (2023) ensure the following:

1. Completion of the disposition of classified material.
2. Clearance of a final patent report, if necessary.
3. Clearance of a final royalty report.
4. No outstanding value engineering change proposals.
5. Receipt of a plant clearance report.
6. Receipt of property clearance.
7. Settlement of all interim or disallowed costs.
8. Completion of price revision.
9. Settlement of subcontracts by the prime contractor.
10. Settlement of prior-year indirect cost rates.
11. Completion of a termination docket.
12. Completion of a contractor audit.
13. Completion of a contractor's closing statement.
14. Submission of a contractor's final invoice.
15. Completion of a contract funds review, including de-obligation of excess funds.

After all the specified steps are completed, the contracting officer ensures that a contract completion statement is prepared, indicating that all necessary contract administration actions have been fulfilled. The contract closeout process comes to a conclusion once this statement is completed. The signed original statement is then stored in the contracting office file, or if contract administration is handled by a contract administration office (CAO), a signed copy is placed in the contract file. Figure 4 illustrates the contract closeout process.

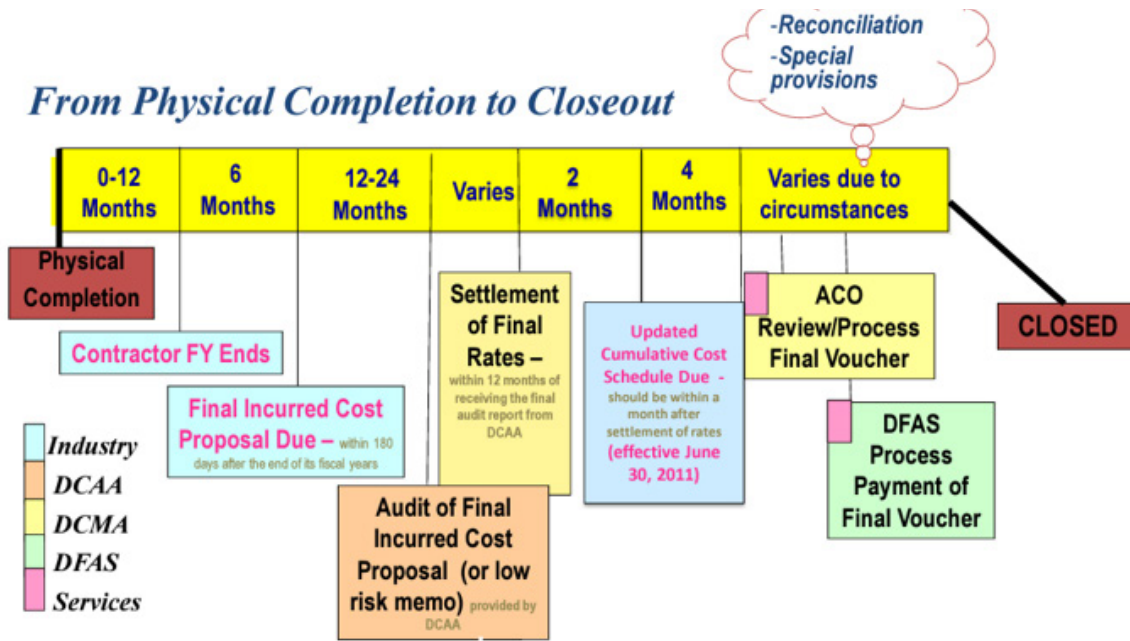


Figure 4. Contract Closeout Process. Adapted from Ruffin (2022).

Prompt and efficient closure of contracts is crucial as it enables the government to accurately settle its financial accounts, marking the final phase in the contract life cycle. One notable example is the management of unliquidated obligation (ULO) balances—appropriated funds that remain on contracts after the conclusion of physical performance and contractor invoice liquidation. If ULO balances are not de-obligated before the expiration of the fiscal year appropriation life cycle, these funds become inaccessible for reprogramming to other contracts. This compromises the government’s capacity to efficiently manage taxpayer dollars within an annual budget, negatively impacts future contract obligations, and ultimately erodes public trust. FAR 4.804-1 provides comprehensive guidelines and time standards that govern the federal contract closeout process, as depicted in Table 1. Contract types that exceed FAR time standards are considered overage.

Table 1. FAR Time Standards for Contract Closeout.  
Adapted from Busansky (2003).

Contract Type	Calendar Months After The Month in Which Physically Completed
Contracts Using Simplified Acquisition Procedures	Evidence of Receipt and Final Payment
All Other Firm Fixed-Price Contracts	6 Months
Cost-Reimbursement Contracts including Time and Material (T&M) and Labor Hour (LH) contracts.	36 Months
All Other Contract Types	20 Months

The closeout process necessitates complex coordination among multiple entities (as shown in Figure 5), including procuring contracting offices, payment offices, field administration offices (FAOs), program offices, auditing offices, security offices, legal offices, and contractors (DOD, 2019). This collaborative effort represents the culmination of a contract’s life cycle, where the organizational priorities and internal procedures of all involved entities converge to administratively close a federal contract.

Ironically, even though contract closeout plays a crucial role in federal contracting, it frequently receives the lowest priority among most contracting activities. This is because the primary focus is often on awarding new contracts to ensure that end users can access the necessary goods and services to fulfill mission requirements (DOD, 2019). As a result, literature over the past three decades has consistently highlighted government contract closeout as a systemic weakness within organizations, subject to repeated investigations and scrutiny.



Figure 5. Key Players in Contract Closeout. Source: DOD (2019).

#### **D. LITERATURE CONCERNING CONTRACT CLOSEOUT BACKLOGS**

The literature in this section provides a historical basis relevant to the problem of contract closeout backlogs.

##### **1. Report 92-076, Administration of the Contract Closeout Process Within DOD**

This 1992 report is the final of a four-part series initiated by the President’s Council on Integrity and Efficiency (PCIE) to scrutinize the contract closeout process across different government entities. In particular, this audit report evaluates the administrative contracting officer (ACO) files and accounting and finance payment files spanning from June 1977 to September 1990 at both the Defense Contract Management District Mid-Atlantic (DCMDM) and the Defense Contract Management District West. These two contract administrative activities are subordinate commands within the Defense Contract Management Command (DCMC) organization previously flagged for issues in their contract closeout processes. The overall objective of the PCIE’s audit reports is “to determine whether the contract closeout process is accomplished efficiently and effectively” (Inspector General, DOD [IG, DOD], 1992, p. 2).

In the context of this report, the PCIE has established specific objectives (IG, DOD, 1992) that include:

1. Confirming the receipt of goods and services from contractors.
2. Confirming the accuracy of government payments.
3. Evaluating the effectiveness of internal controls related to the contract closeout process.
4. Assessing internal controls related to the accuracy of the Mechanization of Contract Administration System (MOCAS) database.

A significant emphasis is placed on scrutinizing the MOCAS database's internal controls, a system integral to monitoring contract statuses and streamlining the closeout process. While the findings of the PCIE's report focus on how MOCAS database errors and workforce training shortfalls contributed to delayed contract closeouts, a notable issue in the report is the DCAA's prolonged audits of contractors' incurred costs that are used to reach settlement on overhead rates. The audit reveals that a backlog of the DCAA's incurred cost audits extended the contract audit waiting time, exceeding the allowable 36-month period for the entire contract closeout process, especially for cost-type contracts. By January 1990, DCMDM had "13,000 overage contracts valued at \$3.7 billion" (IG, DOD, 1992, p. 5).

This government report presents a historical snapshot of how the untimeliness of incurred cost audits substantially delays the FPC closeout process, in federal contracting.

## **2. Report 93-058, Summary Report on Audits of the Contract and Grant Closeout Process**

This 1993 report summarizes the results of contract audits and grant closeout process audits made by five participating Inspectors General (IGs), and the GAO. Specifically, this audit report summarizes 15 audit reports issued by IGs of the DOD, Department of Commerce, Department of Education, Department of State, Federal Emergency Management Agency, and the GAO from January 1990 to April 1992. The overall objective of the audit is "to determine whether the contract and grant closeout



process is accomplished efficiently and effectively” (President’s Council of Integrity and Efficiency [PCIE], 1993, p. 1).

In this particular report, three of nine of the PCIE’s specific objectives are applicable to our research:

1. The timeliness of contract and grant closeout;
2. The adequacy of contract and grant tracking systems;
3. The impact of delays in the DCAA’s auditing of overhead rates.

Regarding the timeliness of contract or grant closeout, the DOD and Department of State IGs determine that individual contract files have remained open from one month to more than 14 years beyond the FAR contract closeout timeframes (PCIE, 1993, p. 5). Notably, this occurs because the contract closeout process receives low priority relative to the total workload of the contracting activities. Additionally, ACOs are not adequately trained or held accountable for the closeout process in their performance appraisals (PCIE, 1993, p. 5). These three causes for untimely closeouts led the government to reallocate funds from current projects and imperil future budget plans.

During the timeframe this summary report covers, Public Law 101-510, also called the National Defense Authorization Act (NDAA) for FY1991, was passed on November 5, 1990. The law eliminated merged, or “M” accounts, that were used to hold expired funds indefinitely for future disbursements. Instead, dedicated accounts for expired funds accounts are introduced, valid for up to 5 years. After this period, any remaining funds—both obligated and unobligated—are canceled and the expired funds account is closed (PCIE, 1993, p. 7). This legislative update incentivized contracting organizations to prioritize timely contract closeout.

According to the report, DOD has the most comprehensive system to track the status of administered contracts. Still, there are several observations of missing contract files and inaccurate or incomplete data in the database that contribute to delayed contract closeout. This audit finding is applicable to our research because it highlights the necessity of accurate data to efficiently track contracts through the closeout phase.

Similar to the findings in DOD IG Report 92-076, the PCIE (1993) mentions that a backlog of DCAA incurred cost audits delayed contract closeout for the DOD, Department of Commerce, and the Agency for International Development. Since Public Law 101-510 was implemented during the period of time covered by this report, it appears the DCAA adjusted its audit priorities to accomplish more incurred cost audits before expired contract funds were canceled.

This government report provides an example of when the DCAA has had to adjust its organizational priorities in order to reduce incurred cost audit backlogs.

### **3. Streamlining the Contract Closeout Process**

Valvocien's (1995) research presents three interesting conclusions:

1. Organizations that are engaged in contract closeout tend to rate the closeout steps that require involvement from the DCAA and/or contractor as more challenging than the closeout steps where the ACO is solely responsible for the closeout process.
2. Closing cost-type contracts, including fixed-price-incentive contracts, is generally more complex than closing fixed-price contracts.
3. The contract closeout process demands a significant level of coordination among the various activities and parties involved.

In his research, Valvocien adopted a research approach that involved the analysis of data collected through interviews and a questionnaire. The study aimed to evaluate the management of the contract closeout process across 50 different commands within the Defense Contract Management Command (DCMC) and selected Department of the Navy contracting activities. The questionnaire (Valvocien, 1995) served the following objectives:

1. Assessing the frequency of occurrence of each of the fifteen contract closeout steps specified in FAR 4.804-5.
2. Evaluating the level of difficulty associated with performing these steps, utilizing a rating scale ranging from one (1) to five (5). Participants provided responses for both fixed-price and cost-type contracts.

The questionnaire results indicate that, with the exception of “the termination docket is completed,” all of the closeout procedures are more frequent and pose greater challenges for cost-type contracts compared to fixed-price contracts, as concluded by Valvocien (1995). Among the closeout steps, four procedures stand out as significantly more challenging than the other eleven:

- Resolving all interim/disallowed costs.
- Completing price revisions.
- Settling prior year indirect cost rates.
- Concluding the contract audit.

A noteworthy characteristic shared by all four of these steps is that each involves the participation of three or more organizations in carrying out administrative actions related to the closeout process. Valvocien’s (1995) research findings align with earlier government audit reports and suggest that these specific areas continue to be the major obstacles to achieving efficient and effective contract closeout.

Another relevant finding arises from one of Valvocien’s follow-on questions: “What specific area(s) impede your ability to closeout a contract within the prescribed timeframes?” 42% and 31% of respondents indicate that contractor late final invoice submissions and the DCAA, respectively, are “the foremost obstacles to the timely closeout of contracts” (Valvocien, 1995, p. 64). The principal reasons given for the DCAA’s contribution to untimely contract closeout are a backlog of pending incurred cost audits, the length of time required for an incurred cost audit to be completed after it begins, and the subsequent effect of delayed overhead rate negotiations with the contractor. Of the six recommendations Valvocien (1995) presents, two of them seem relevant to our research:

- By defining specific timeframes for each step or factor of the contract closeout process, tailored to the contract type and dollar value, both the contractor and government can better plan and allocate necessary resources effectively. This approach enhances the efficiency and transparency of the closeout process, ensuring that it progresses in a well-organized and manageable manner.

- “Perform all actions possible that can be accomplished during contract performance in order to facilitate the closeout process once the contract becomes physically completed. This enables ACOs to review individual cost-type contracts to determine if the criteria for quick closeout (QCO) are met, and then to utilize QCO procedures to reduce the magnitude of indirect rate audits” (Valvocien, 1995, p. 78).

Valvocien’s (1995) research provides informative evidence of how the contract closeout process is more difficult to complete for cost-type and fixed-price-incentive contracts that also bear the added complexity of more involved stakeholders. Additionally, his research findings provide credible evidence that the contract closeout process is more difficult to complete when a DCAA audit is required.

#### **4. A Case Study of the Contract Closeout Process at Defense Contract Management Command Lockheed Martin Missiles and Space**

Bandy’s (1998) research in the contract closeout process builds on previous literature that discusses the common reasons for late contract closeout in federal contracting: low priority assigned to contract closeout, inaction by the contractor, inaction by the DCAA, and lack of internal controls. These causes lead contracts to become overage. Bandy’s research takes an approach to highlight the importance of instituting realistic organizational goals with specific production metrics that accurately measure contract closeout effectiveness. The scope of his research involves the DCMC and one of its subordinate contracting activities, DCMC Lockheed-Martin (DCMC LM). In the report, Bandy presents one primary research question and several secondary research questions. In our study, the findings of Bandy’s three following research questions are considered:

- What are the metrics that DCMC uses to monitor contract closeout performance, and what do those metrics suggest about the contract closeout process (Bandy, 1998, p. 2).

According to Bandy (1998), the Defense Contract Management Command (DCMC) employs ten critical contract closeout metrics. However, they report only three of these metrics to the commander in a monthly memo. These three key metrics are:

1. Open overhead negotiations: This metric tracks the cumulative number of fiscal years in overhead costs that require negotiation with contractors at the conclusion of each reporting period.
2. Percentage of overage contracts: This metric measures the percentage of physically completed contracts that exceed the Federal Acquisition Regulation (FAR) timelines and remain unclosed, relative to the total number of administered contracts at the close of each reporting period.
3. Funds at risk of being canceled: This metric quantifies the Unliquidated Obligation (ULO) dollar amount of contracts with funds that are scheduled to cancel at the conclusion of the current fiscal year.

Using these metrics, the DCMC sets specific performance goals for each of its districts, and the whole DCMC organization. By tracking contracts with open overhead negotiations, the DCMC separates the backlog of overage contracts from the total workload of current contracts that require overhead negotiations, then establishes a trendline that depicts overage contract backlog reduction efforts at each district command. After reviewing the results, the metric later leads the DCMC to conclude that its organizational goal of reducing the backlog of overage contracts to below the DOD's target of 24 months is unrealistic (Bandy, 1998). While the DCMC fails to achieve its organization goal of reducing overage contracts to below 15%, the second metric provides valuable insight into the number of overage contracts within its total population of administered contracts. The DCMC's third metric successfully assists the DCMC to reduce the amount of funds at risk of cancellation "from about \$1.9 billion at the outset of FY1998 to just over \$200 million at the end of the fiscal year" (Bandy, 1998, p. 57)—a significant savings of appropriated funds.

Each of the DCMC's metrics add context that metrics are necessary to measure organizational performance in federal contract closeout.

- What are the contract closeout metrics used at DCMC LM and how do they compare to the DCMC's metrics (Bandy, 1998, p. 2)?

DCMC LM uses the metrics mandated by DCMC and adds two internal metrics—*contracts closed as a percentage of physically complete contracts in closeout* and *percent of canceling funds to ULOs*—to obtain more accurate data that represents the DCMC LM’s contract closeout performance.

According to Bandy’s (1998) analysis, the DCMC’s *percent of overage contracts* metric has flaws and can be manipulated to present erroneous results that best suit the reporting organization. Specifically, “by holding physically complete contracts in the active category and moving the large numbers of them into the physically complete category at the appropriate time, managers can decrease their percentage of overage contracts without ever closing a single contract” (Bandy, 1998, p. 87). As a measure to improve accuracy and better measure the actual percentage of contracts closed, DCMC LM measures contracts closed as a percentage of physically completed contracts instead of measuring overage contracts as a percentage of total administered contracts (Bandy, 1998). Using the DCMC LM’s metric alongside the DCMC’s metric, DCMC LM shows improvement only when it closes contracts.

In Bandy’s (1998) analysis, he points out that the DCMC’s *funds at risk of being canceled* metric is also flawed because it “does not separate at-risk funds from funds not at-risk on active contracts” (p. 88). In contrast, DCMC LM employs a different metric known as the “percent of canceling funds to Unliquidated Obligations (ULOs).” This metric provides a more accurate assessment of the risk associated with the canceling funds process by measuring the amount of funds that are slated to be canceled at the close of the fiscal year, specifically for physically complete contracts. This approach focuses on contracts that have reached a state of physical completion, enhancing the precision of the assessment (Bandy, 1998). By employing this calculation method, the DCMC LM separates funds that will be canceled at the end of the fiscal year, for physically completed contracts, from funds that will not be canceled on active contracts. This enables the organization to prioritize its efforts to de-obligate and repurpose the at-risk funds on physically completed contracts to other contracts.

Bandy’s report describes how this metric enables the DCMC LM, in FY1997, to de-obligate all but \$2.9 million of \$2.5 billion (a de-obligation rate of 99.89%) of at-risk

ULOs on physically completed contracts—another significant savings of appropriated funds.

Both of DCMC LM’s internal metrics provide sound examples of how contract closeout metrics are necessary and enable contracting commands to measure contract closeout performance, and reduce backlogs. More importantly, the metrics an organization adopts must accurately measure contract closeout performance.

- What specific actions and initiatives are being implemented at the DCMC LM, and what other actions could help them improve the contract closeout process (Bandy, 1998, p. 2)?

According to Bandy, in 1995, the DCMC LM initiates the Process Oriented Contract Administration Services (PROCAS) Contract Closeout Team to improve its contract closeout process. Established through a series of memorandums of agreement with external organizations, the DCMC LM’s PROCAS Contract Closeout Team includes representatives from DCMC LM, the DCAA, and Lockheed Martin Missiles and Space “to provide a more efficient contract closeout process and allow a ‘meeting of the minds’ between the three organizations” (Bandy, 1998, p. 93). The PROCAS initiative immediately produces favorable results for the DCMC LM. As an example, in the two years leading up to the establishment of the PROCAS Team, DCMC LM managed to close only 35 prime contracts. Three years after establishing the PROCAS Team, DCMC LM closes 218 prime contracts—a 523% increase in closed prime contracts. Additionally, contract audit time decreases “from an average of 95 days per contract, in 1995, to only 38 days per contract, in 1997” (Bandy, 1998, p. 94). This is a 150% reduction in contract audit time. The DCMC’s PROCAS framework is eventually adapted to improve contract administration across the DCMC enterprise.

The relevance of this report lies in that the DCMC LM formulated and improved its contract closeout metrics to obtain more accurate closeout data, and improved its contract closeout productivity by involving stakeholders from external organizations that contribute to the closeout process. Both of these points are relevant to our study of the DCMA’s case.

## 5. Transformation of Department of Defense Contract Closeout

At the request of the Assistant Secretary of the Navy for Research, Development, and Acquisition, Byrdsong and colleagues (2003) are conducting a statistical analysis of Navy data found in Section 2 of the Mechanization of Contract Administration Services (MOCAS) database. This section pertains to contracts that are physically completed but not yet closed, and the analysis covers the period from February 2002 to February 2003 (p. 10). The research team is examining the current contract closeout process and providing recommendations for enhancing the process with the goal of reducing the existing backlog of physically completed contracts.

Their analysis introduces the application of “Little’s Law” as a quantitative method to model the relationship concerning contract closeout backlogs for cost-type contracts. The equation (Byrdsong et al., 2003, p. 27) utilized in this context is:

- Inventory (I) = Arrival Rate (R) x Turnaround Time (T), or  $I = RT$ .

This equation helps illustrate how inventory (the backlog of contracts) is influenced by the arrival rate of new contracts and the time it takes to complete the closeout process, providing insights into potential improvements.

In the context of the analysis, *Inventory (I)* represents the number of physically completed contracts that are currently available for closeout. *Arrival Rate (R)* signifies the number of contracts that attain physical completion per month. *Turnaround Time (T)* denotes the amount of time required to complete the contract closeout process after a contract has achieved physical completion. (Byrdsong et al., 2003). Each simulation comprises 10,000 trials and adopts the FAR timeframe of 36 months to close a contract after its physical completion as a baseline for the turnaround time. Acknowledging that contract closeout is an evolving process, Byrdsong and colleagues present six simulated scenarios featuring realistic assumptions. These scenarios are designed to illustrate the correlation between contract closeout backlog levels and the arrival rate and turnaround time of physically completed contracts. Using a 90% confidence interval, the first three simulation results show the effects of:

1. 20% variability in the arrival rate,



2. 20% variability in the turnaround time, and
3. 20% variability in both variables.

It is noted that the third simulation is the most realistic configuration of variables “due to the high degree of variability noted in the data” (Byrdsong et al., 2003, p. 31). After the first battery of simulations, Byrdsong et al. identifies that reducing variability is one way to reduce backlog levels in contract closeout.

Under the assumption that the arrival rate (the rate at which contracts attain physical completion) remains constant and cannot be decreased, the following three simulations utilize a hypothetical rate of 100 contracts per month. These simulations are employed to demonstrate the impact of altering only the time required to complete a contract after it achieves physical completion (Byrdson et al., 2003). This configuration is used since contract closeout time is a variable that can be controlled.

With a 90% confidence interval, the outcomes of the last three simulations clarify the consequences of the following scenarios (Byrdson et al., 2003):

- Employing a mean turnaround time of 36 months while reducing variability from 20% to 10%.
- Decreasing the mean turnaround time by 10% while maintaining the 20% variability.
- Reducing both the mean turnaround time and variability by 10%.

After completing all six simulations, Byrdsong et al. concludes that variability in the turnaround time is the root cause of contract closeout backlogs. Furthermore, Byrdsong et al. (2003) highlight the existence of two sources of variability in turnaround time:

- **Process Variability:** This pertains to the variability arising from the number of steps required to complete the contract closeout process, considering that each contract is distinct in its requirements.
- **Queue Variability:** This relates to the amount of time a contract spends in a queue before and after each step in the closeout process, which can fluctuate and affect the overall turnaround time.

Of these two sources, queue variability is assessed to be the more significant root cause of contract closeout backlogs. Additionally, the settlement of indirect cost rates—a result of the contract audit process—presents the largest cause for queue variability within the context of closing cost-type contracts.

Byrdsong et al.'s (2003) assessment is meaningful because it proves that minimizing the amount of time that physically completed contracts sit in a queue has “the greatest and most immediate impact on reducing a backlog of overaged cost-type contracts” (p.35). A primary recommendation Byrdsong et al. (2003) suggests is “to identify contracts that are eligible for QCO procedures and enforce the FAR requirement that states the contracting officer shall negotiate settlement of indirect cost for a specific contract in advance of determining the final rates” (p. 130).

Use of QCO procedures will resurface in Chapter IV of our report.

## **6. The Analysis of the Closeout Process and Recommendations for Reducing Backlogs**

St. Peter and Hall (2022) identify that key contributors to contract closeout backlogs are low prioritization of the closeout process, minimum leadership involvement, more focus on pre-award workload, and late final invoice submissions by contractors. Through interviews with contracting personnel at the U.S. Army Health Contracting Activity, a command responsible for acquisition and contract administration for Army hospitals and clinics in the United States and European countries (St. Peter & Hall, 2022), the research team aims to uncover effective business strategies for mitigating contract closeout backlogs. One of the survey questions asked by the research team is: “Any thoughts or challenges with outsourcing contract closeout workload?” The most popular response to this question is a recommendation to outsource contract closeout support when workload exceeds a contracting organization’s capacity. A primary conclusion from St. Peter and Hall’s (2022) research is that the contract closeout process suffers due to constrained resources when surges of new contracts increase administrative workload.

In the context of our research, St. Peter and Hall rightly present the contract closeout services procurement option as a viable pathway to increasing contract closeout capacity during surges in administrative closeout workload.

## **E. SUMMARY**

In this chapter, we introduce federal contracting, the contracting life cycle, and the contract closeout process. Implications involving different contract types, and the different levels of risk shared between the government and the contractor, are also discussed. A review of literature comprising six reports discusses challenges faced by other government contracting organizations and effective strategies to reduce contract closeout backlogs. The literature reviews, when viewed collectively, offer actionable solutions that improve FPC closeout efficiency. They stress the importance of a metric-driven approach to accurately measure contract closeout performance, emphasize the need to tackle queue variability and reduce wait times, and identify outsourcing contract closeout services and utilizing QCO procedures, when possible, as potential solutions. The next chapter introduces the key entities in our case study—the DCMA and DCAA.

### **III. DCMA AND DCAA: KEY PLAYERS IN FLEXIBLY PRICED CONTRACT CLOSEOUT**

#### **A. INTRODUCTION**

In this chapter, we describe the critical roles of both the DCMA and the DCAA in the FPC closeout process. Both DOD organizations are responsible for ensuring the prudent administration and auditing of federal contracts, particularly FPCs. Their interdependence and collective responsibilities underline their significance in the broader federal contracting landscape.

#### **B. DEFENSE CONTRACT MANAGEMENT AGENCY**

A key player in federal contract administration, the DCMA stewards myriad DOD contracts through the closeout process, especially in the domain of FPCs. As the custodian of contract administration services for the DOD, various federal entities, and international partners, DCMA holds a crucial role in the contract life cycle, from pre-award to post-award. With a global footprint and a workforce of around 11,000 employees, the majority of which are civilians, DCMA carries an extensive portfolio. As of 2023, the agency is tasked with managing an astounding 225,000 contracts, collectively valued at over \$3.5 trillion, spread across 15,000 contractor locations worldwide (DCMA, n.d.a). This immense responsibility encompasses various contract types, from FFP contracts to cost-reimbursement contracts, which are referred to as FPCs throughout the remainder of the thesis report.

The DCMA's role as a key player in the defense contract closeout process has also been marked by significant challenges and milestones. One of the most pressing challenges was the accumulation of an extensive backlog of overage contracts awaiting administrative closeout, a matter identified during an internal assessment in FY2012 (DCMA, n.d.). At that time, the DCMA attributed the backlog to several factors, notably the inability to settle final overhead rates due to delayed ICP audits, by the DCAA. The overage contracts backlog originated from the DCAA's organizational shift in focus from auditing contractor ICPs to reviewing newly awarded contract forward pricing rate proposals (FPRPs)

submitted by contractors. The DCAA’s shift created a negative compounding effect in the DCMA’s contract closeout process, and by the beginning of FY2015, overage contracts surged to nearly 72,000, as shown in Figure 6.

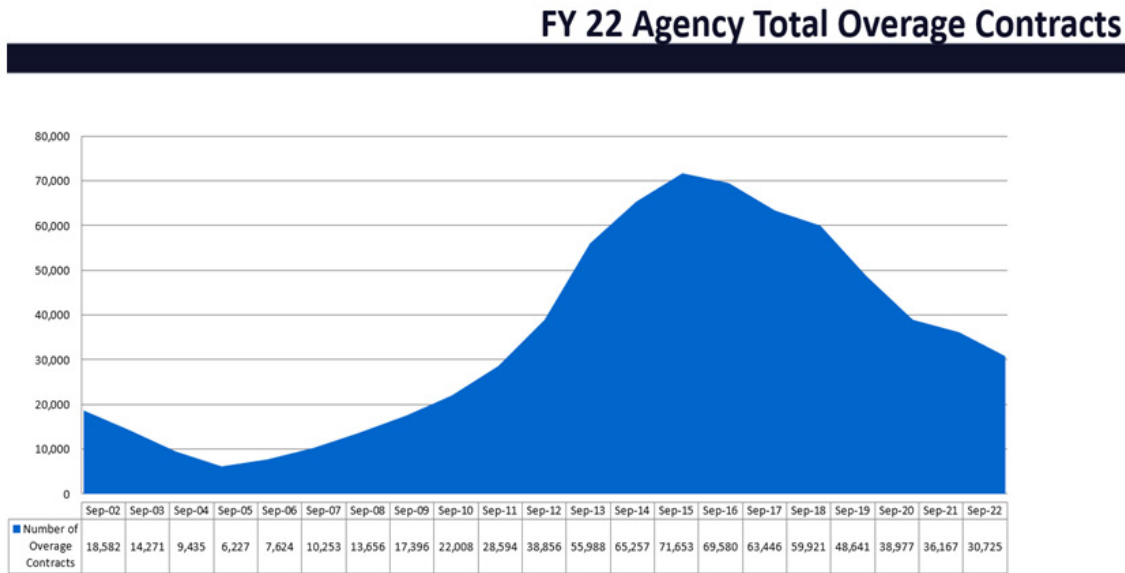


Figure 6. Backlog of Overage Contracts. Source: DCMA Contract Administrator (PowerPoint slides, October 7, 2021, slide 6).

To address this formidable backlog and fulfill its mission as a key player in defense contract closeout, the DCMA devised a comprehensive plan of action (see the appendix). The success of this initiative was to be measured through the annual reduction in quantity and dollar value for FPCs by 20% and by ensuring that no more than 350 overage FFP contract closeouts remained (DCMA, n.d.).

The path to clearing this backlog saw a series of targeted steps and checkpoints carried out by DCMA:

- During the third quarter of FY2012, the DCMA, in collaboration with the DCAA, identified a list of indirect rate proposals that, if completed, would significantly contribute to closing a substantial number of contracts (DCMA, n.d.).

- By the fourth quarter of FY2012, the DCMA achieved a noteworthy milestone with the issuance of a class deviation memo authorizing contracting officers to use either an audit report from the DCAA or an adequacy review memo to satisfy the DCAA's audit requirements. This move facilitated a new low-risk contract sampling plan that streamlined the DCAA's ICP audit process (DCMA, n.d.).
- The following year, during the first quarter of FY2013, the DCMA took further steps by using the DCAA's low-risk memorandums (LRMs) to streamline the FPC closeout process. Additionally, a contract closeout blitz was initiated to identify FPCs within the DCMA's control, leading to the closure of 4,036 contracts, which accounted for 26% of the starting overage contract population (DCMA, n.d.).
- Subsequent quarters witnessed continued progress, with the DCMA partnering with the Defense Accounting and Finance Services (DFAS) and the DCAA on tri-agency working groups, developing training packages for its contract specialists, and strategically elevating the contract closeout process, with special focus on overage contracts (DCMA, n.d.).
- The culmination of these efforts, spanning several years, resulted in a substantial reduction in the backlog of overage contracts. By the end of FY2020, the DCMA had reduced its overage inventory by a remarkable 34,197 contracts from its highest point in FY2015, bringing it down to 37,456 contracts, as shown in Figure 6.
- From FY2016 to FY2020, the largest amount of FPC closeouts occurred (see Figure 7).

## Flexible Priced Contracts Closed

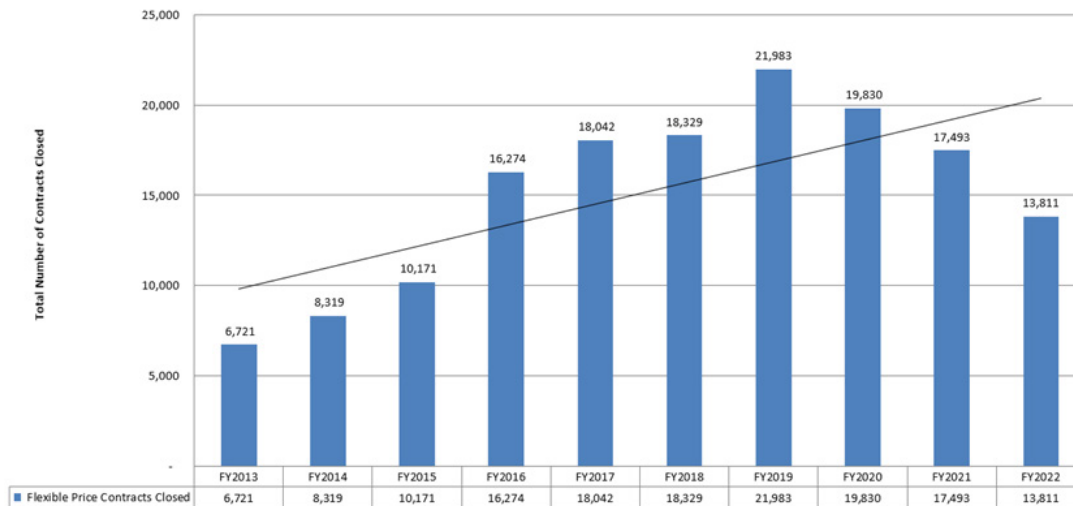


Figure 7. FPCs Closed from FY2013 to FY2022. Source: DCMA Contract Administrator (PowerPoint slides, October 7, 2021, slide 4).

Central to these accomplishments was the establishment of two Contract Closeout Centers (CCCs), which gave management oversight to FPCs with settled rates still open (i.e., the ICP audit or an adequacy review was still pending) but with the potential to be closed. These centers served as hubs for overage contract closeout administrative functions, staffed with dedicated government and contracted personnel. By leveraging the capabilities of these centers and engaging in strategic collaborations, the DCMA was able to streamline the closeout process and expedite the closeout of contracts (DCMA, n.d.). At present, the DCMA continues its dedication to reducing the backlog of overage contracts while maintaining a focus on timely contract closeouts. The agency’s commitment to this mission includes internal metrics established to increase the rate of on-time closeouts, ultimately benefiting both the federal government and industry stakeholders (DCMA, n.d.).

In FY2021, the DCMA strategically realigned its focus, with each of its CMOs concentrating on closing non-overage FPCs, while the CLMC has intensified efforts to close overage contracts. This strategic shift aims to reduce the backlog of overage contracts while ensuring timely closeouts (DCMA, n.d.).

As the DCMA continues to track its progress toward achieving its goals and reducing the backlog of overage contracts, it remains a key player in the defense contract closeout process, contributing significantly to the efficient and effective management of federal contracts.

### **C. DEFENSE CONTRACT AUDIT AGENCY**

Another significant contributor to the contract closeout process is the DCAA, which offers audit and financial advisory services to the DOD and other federal entities responsible for acquisition and contract administration. Established in 1965 after Secretary of Defense Robert McNamara directed that a study be performed on the non-uniformity in contract administration and audit standards between the military services, the DCAA became the singular agency responsible for auditing defense contracts. Operating under the authority and oversight of the Undersecretary of Defense (Comptroller)/Chief Financial Officer, the primary mission of the Defense Contract Audit Agency (DCAA) is to carry out contract audits and provide associated financial advisory services. Contract audits conducted by the DCAA are impartial and professional evaluations of financial claims presented by defense contractors. The agency's role is to assist in determining the allowability, allocability, and reasonableness of contract costs (Defense Contract Audit Agency [DCAA], n.d.a). As of FY2022, the DCAA's workforce comprised 3,555 employees located at 230 offices throughout the United States; all but nine states have physical offices, as shown in Figure 8. In the same fiscal year, the government's primary auditor examined approximately \$262 billion in contract costs, from which a net savings of \$3 billion was recovered.

In its early stages, the DCAA functioned as a headquarters entity with seven subsidiary organizations or regions, each named after major cities. While the regional construct has persisted, the regional names have changed over the years, transitioning from cities to geographical regions. In 2016, the agency underwent a significant reorganization, resulting in its present structure consisting of three geographical regions, four corporate audit directorates, and a field detachment for classified work (DCAA, n.d.a). In its early years, the DCAA's workforce was tasked with developing uniform audit guidance, leading



to the creation of the first Contract Audit Manual (CAM). The CAM underwent numerous revisions, and it wasn't until 1988 that the CAM was printed in a paperback version and then transitioned to an online version, in 2013.

The DCAA plays a critical role in the financial oversight of government contracts. ensures that the Department of Defense (DOD) receives the optimal value for every dollar invested in defense contracting (DCAA, n.d.a). In the context of contract closeout, especially for FPCs, the DCAA plays a significant role. FPCs require incurred cost proposal (ICP) audits to be completed before they can be closed out by the DCMA. The DCAA's audits of these Incurred Cost Proposals (ICPs) assist in determining whether contract costs are allowable, allocable, and reasonable (DiNapoli et al., 2012). This process is essential for closing out contracts efficiently and prudently, aligning with the DCAA's historical mission of saving taxpayer dollars.

With this background about the DCMA's and DCAA's missions and roles in the contract closeout process, it is prudent to examine the literature about organizational priorities and internal procedures during the period from FY2015 to FY2020 to provide a comprehensive baseline knowledge of these organizations' contributions to the federal contract closeout process.

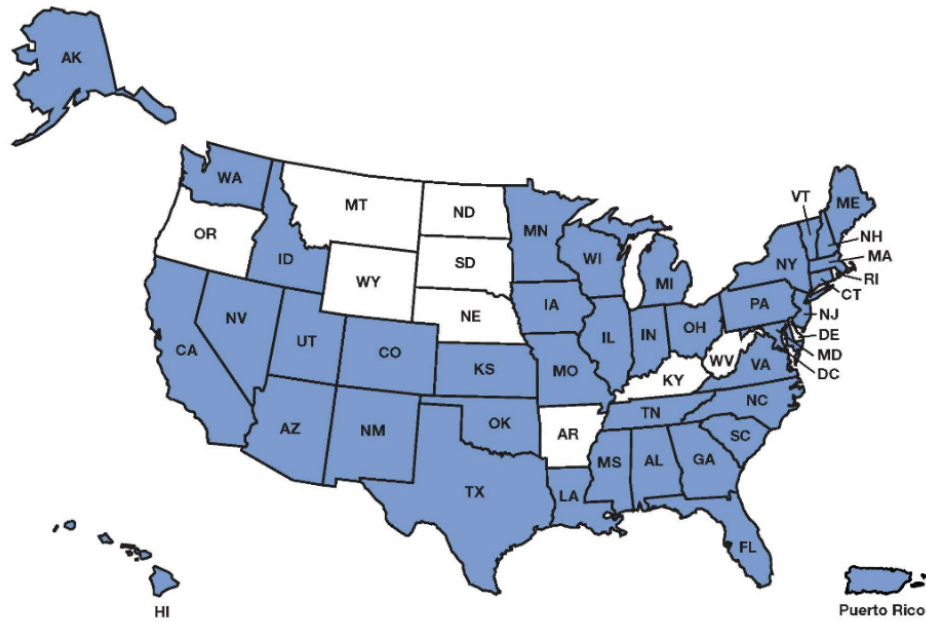


Figure 8. Physical Locations of DCAA Offices.  
 Source: Defense Contract Audit Agency (n.d.b).

#### D. SUMMARY

This chapter presents the roles and responsibilities of the DCMA and DCAA in the federal contract closeout process. We describe the DCMA’s contract management role and its initiative to address the backlog of overage FPCs. On the other hand, the DCAA’s focus on auditing defense contracts and ensuring financial integrity is described, highlighting its crucial function in the FPC closeout process. As key players in the defense contracting landscape, their individual missions form an essential backdrop to our exploration of the DCMA’s FPC closeout process.

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## **IV. ANALYSIS OF ORGANIZATIONAL PRIORITIES, INTERNAL PROCEDURES, AND SYSTEMIC DELAY**

### **A. INTRODUCTION**

In this chapter, we explore how misaligned priorities and conflicting procedures between the DCMA and the DCAA caused the systemic delay of backlogged flexibly priced contracts (FPCs) awaiting administrative closeout. We present the steps taken by both organizations to identify weaknesses in core business activities. Subsequently, we examine the impact of the DCMA's actions to reduce its FPC backlog. Using external reports, organizational memorandums, charts, graphs, and manuals, our analysis aims to unravel the challenging interplay of priorities and procedures between both organizations during the DCMA's Material Weakness Initiative (MWI) to reduce the overage FPC closeout backlog. By connecting these sources of friction, we endeavor to reconstruct the environment faced by the DCMA, then aim to reveal how aligning organizational priorities and internal procedures empowers the DCMA's MWI to reduce an FPC backlog to acceptable levels.

### **B. ORGANIZATIONAL PRIORITIES**

The DCMA and the DCAA serve different but complementary roles within the DOD. Each organization focuses on distinct contract management and oversight aspects. The DCMA is responsible for the entire contract management life cycle, ensuring defense contractors deliver quality products on time and within the allocated budget. In tandem, the DCAA plays a support role in defense contracting and conducts financial audits to provide federal contracting organizations an assurance that costs claimed by contractors are allowable, allocable, and reasonable (DiNapoli et al., 2012). Differing priorities between these two organizations can create procedural bottlenecks and systemic delay in the FPC closeout process. For instance, while the DCMA may be more focused on expediently meeting contract administration deadlines to support operational readiness requirements for military units, the DCAA prioritizes the thoroughness and accuracy of financial audits, which can be time-consuming and exacerbate the DCMA's FPC closeout backlog. This

divergence in organizational foci stalls the FPC closeout process, as the DCMA generally cannot proceed with negotiating final rates and making a final payment to the contractor until the contract audit is complete by the DCAA.

Discrepancies arising from the DCAA's audits require the DCMA to spend additional time reconciling issues before a contract can be closed. This eventually causes FPCs to exceed FAR 4.804-1 (2023) contract closeout time standards. Differing priorities can also lead to communication gaps between the two agencies, further complicating the FPC closeout process. The administrative burden on contractors, stemming from the unique forms, reports, and approvals required by each agency, can contribute to delays. Any changes in regulatory frameworks, such as the FAR and Defense Federal Acquisition Regulation Supplement, can add another layer of complexity, as one agency's updated priorities or processes may not immediately align with the other's, leading to increased closeout delays. Therefore, misaligned organizational priorities between the DCMA and the DCAA present difficult challenges and uncertainties in the FPC closeout process.

In the following sections of this chapter, we analyze how the priorities of both organizations interact to create FPC closeout issues for the DCMA, and the subsequent steps the DCMA takes to close a substantial number of overage FPCs.

### **1. DCMA's Material Weakness Initiative**

In FY2012, the DCMA identified its contract closeout functional area as an internal weakness during a Managers' Internal Control Program self-assessment (DCMA, 2014). Initial corrective actions aimed to establish a baseline for overage FPCs and reduce their quantity, along with the associated obligated funds, by 20% annually. The baseline included those contracts for which final overhead rates were settled or the DCMA was in receipt of the incurred cost proposal (ICP) audit. These contracts were classified as fully under the DCMA's control (i.e., there is no pending administrative action by an external organization). Shortly after the baseline was established, the DCMA, along with the DCAA, generated a list of indirect rate proposals, which, if completed, would close out most FPCs.

Understanding that this was an issue that needed to be addressed in all sectors of the DOD, the director of Defense Pricing and Acquisition Policy (DPAP) issued a class deviation memo authorizing contracting officers to use either a DCAA audit report or a DCAA memorandum to satisfy the audit requirement (Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics [OUSD (AT&L)], 2012). Based on the ACO's risk assessment and a proposal adequacy evaluation pursuant to FAR 42.705-1(b)(1)(iii), the DCAA memoranda deemed contractor ICPs to be low-risk and did not select them for further audit by a DCAA auditor. This strategic shift delivered a two-fold benefit: it decreased the DCAA's ICP audit queue and significantly increased the DCMA's FPC closeout throughput. Consequently, as a result of the class deviation memo, the DCMA was able to close 4,036 contracts (26% of the baseline population of overage FPCs).

That DCMA aimed to reduce the baseline quantity and obligated dollar value of overage FPCs by 20%, annually. This endeavor occurred in phases and was carried out with contracted AbilityOne personnel who provided additional contract closeout support to the DCMA's Contract Closeout Centers (CCC). This allowed the DCMA to create contract closeout teams to support overage FPC closeout at field offices. The DCMA's approach occurred in three phases:

- **Phase 1**—Contract Life cycle Management Center is established at DCMA Headquarters. This functional team provided management oversight to FPCs with settled rates still open.
- **Phase 2**—Interactive training was conducted for the DCMA's contract specialist workforce, including new employees and supervisors.
- **Phase 3**—DCMA International took charge of outside the continental U.S. (OCONUS) contracts, and DCMA Houston was responsible for Logistics Civil Augmentation Program (LOGCAP) III/IV, Air Force Contract Augmentation Program (AFCAP), Space and Naval Warfare Systems Command (SPAWAR), and Iraq contracts.

Throughout this process, the DCMA also established a tri-organizational working group with the DCAA and the DFAS to address closeout issues at the appropriate management level and reconfigure organizational actions to increase the closeout of overage FPCs under the DCMA's control. This group convened monthly to streamline incurred cost proposal (ICP) audits, identify funds at risk of cancellation, and elevate the priority of FPC closeouts. Ultimately, this collaborative effort enhanced FPC closeout by synchronizing actions across all three organizations.

The DCAA's responsibility is to determine whether reported costs by the contractor are allowable, allocable, and reasonable. After costs are audited, the DCMA reviews the DCAA's findings and works with the contractor to negotiate final rates or address any issues. Once the findings have been addressed and the ACO has settled indirect cost rates with the contractor, there is a smoother transition to DFAS to pay the balance of the contractor's final invoice. Since all three agencies play vital roles in the FPC closeout process, it is prudent to form a working group to collaborate and increase overage FPC closeout.

Throughout the defense contracting life cycle, there are occasions when funds need to be de-obligated from contracts. This is especially true during the contract closeout phase. Funds may be de-obligated for various reasons including a change in requirements or because the contractor expended less funds than obligated to the FPC. In any case, the DCMA and the DCAA must ensure all contractor costs are legitimate. DFAS can then adjust the payments or handle the de-obligation of funds from the contract.

The tri-organizational working group gave each agency representation and a platform to discuss which FPCs should enter the closeout process, first. As mentioned earlier, the DCMA is responsible for initiating the closeout audit process by submitting the necessary documents to the DCAA for the contract audit. Once the audit is completed and findings have been adjudicated, the DFAS can proceed with paying the contractor.

Based on the available literature that discusses common issues in federal contract closeout, it is evident that the problem of closeout backlogs is cyclical; there tends to be a catalyst event that influences an organizational shift in focus to more to awarding contracts

than to administratively closing contracts. An example of this catalyst is a workload surge that leads to reallocating contract closeout capacity to newly awarded contracts to ensure that the warfighter has the required goods and services. Understanding this is a flawed approach that historically caused FPC closeout backlogs, the DCMA instituted a cultural shift in importance of contract closeout that included adding this functional area to the DCMA’s strategic plan. This action created a domino-effect in all management levels to prioritize the DCMA’s objective to annually reduce the quantity and dollar value of backlogged overage FPCs, each by 20%.

## 2. DCAA Incurred Cost Audit Backlog

The DCAA plays a vital role in the administration of the contracting life cycle. The most important aspect of that role is conducting the ICP audit. Incurred cost audits are conducted on a contractor’s yearly proposal, encompassing all allowable expenses incurred on specific contracts during that fiscal year. FAR 52.216-7 mandates that contractors submit adequate final indirect cost rate proposals. The FAR also sets time standards in which contracts must be closed, as indicated in Table 2.

Table 2. FAR Closeout Timelines. Source: DCMA (2019).

<b>(FAR 4.804)</b>	
<b>Timeframes</b>	<b>MOCAS Codes and Contract Types</b>
6 Months	J FIRM FIXED PRICE
36 Months	L FIXED PRICE INCENTIVE
	R COST-PLUS AWARD FEE
	S COST CONTRACT
	T COST SHARING
	<del>U COST-PLUS-FIXED-FEE</del>
	V COST PLUS INCENTIVE FEE
20 Months	Y TIME AND MATERIALS
	Z LABOR HOUR
	A FIXED PRICE REDETERMINATION
	K FIXED PRICE W/ECONOMIC PRICE ADJUSTMENT
	O OTHER – BASIC ORDERING AGREEMENT/BLANKET PURCHASE AGREEMENT (BOA/BPA)

For the DCMA to adhere to this standard, the DCAA must promptly complete ICP audits. DiNapoli (2017) revealed that in FY2016, the DCAA had an average duration of



885 days from the moment a contractor submitted a satisfactory ICP to the completion of the audit. To further break down this delay, on average, 747 days were spent with a proposal sitting in a queue waiting for an audit to begin; once the audit began, the audit lasted for 138 days (see Figure 9). This delay was attributed to many things but boiled down to a misalignment of the organizational priorities between the DCMA and the DCAA.

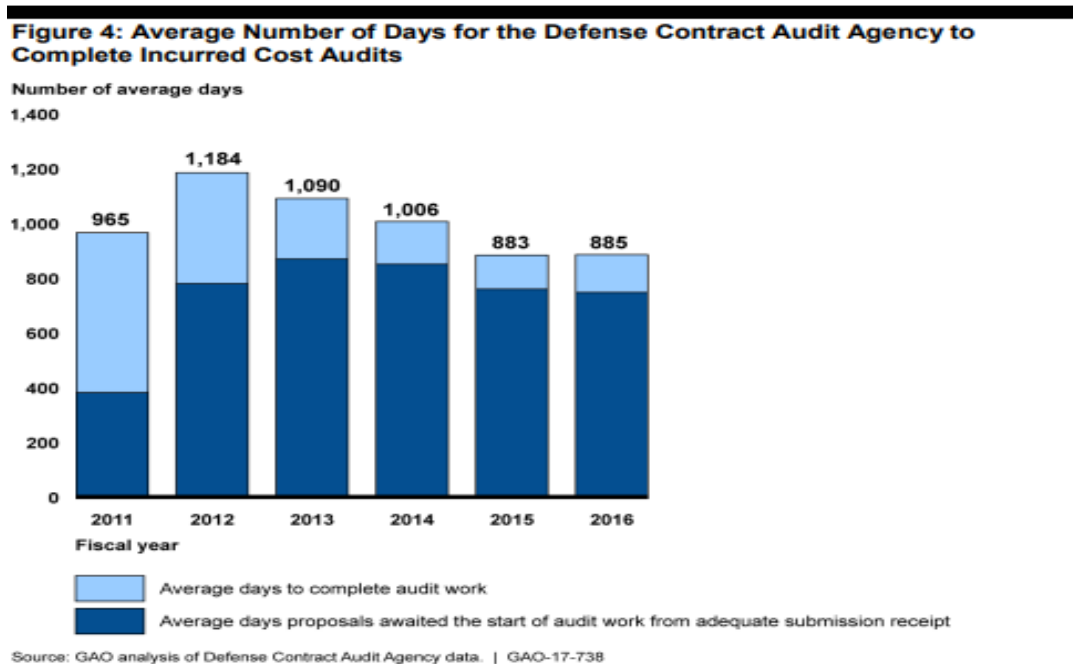


Figure 9. DCAA’s Average Number of Days to Complete IC Audits. Source: DiNapoli (2017).

To aid the DCAA’s increased prioritization of ICP audits, the Office of the Undersecretary of Defense [Acquisition, Technology, and Logistics] (OUSD [ATL]) approved the DCAA’s request to modify its process for sampling low-risk ICPs. Class Deviation 2012-O0013, *DCAA Policy and Procedure for Sampling Low-Risk Incurred Cost Proposals*, allowed the DCAA to introduce a risk-based initiative. This initiative was designed to redirect agency resources towards prioritizing incurred cost audits associated with high-dollar and high-risk proposals. The DCAA’s risk-based initiative also entailed significant modifications to risk classification criteria and procedures, resulting in a

reduction in the number of mandatory Incurred Cost Proposal (ICP) audits. These changes encompassed:

1. Elevating the auditable dollar value (ADV) threshold for proposals to automatically qualify for a DCAA audit, increasing it from \$15 million to \$250 million.
2. Amending the criteria employed to classify a contractor's incurred cost proposal as low-risk.
3. Reducing the sampling percentages for low-risk proposals randomly selected for a DCAA audit.
4. Allowing the Administrative Contracting Officer's (ACO) adequacy review of proposals not chosen for a DCAA audit to serve as a substitute for the DCAA's audit.

As part of the alterations introduced through Class Deviation 2012-O0013, the DCAA conducted an analysis that involved comparing the costs associated with conducting audits at various ADVs against the potential savings derived from identifying unallowable or questioned costs. As a result, the DCAA determined that “it accrued a higher return on investment for proposals with a higher ADVs and that the return on investment was negative for proposals with a lower ADV” (DiNapoli, 2017, p. 25). Table 3 shows the updated percentages by which low-risk ICPs were sampled for a DCAA audit.

Table 3. Proposals Sampled Under Previous and New Procedures.  
Source: DiNapoli et al. (2012).

<b>Table 3: Percentage of Proposals Sampled under Previous and New Procedures</b>		
<b>Auditable dollar value</b>	<b>Sampling percentages for low risk proposals under previous criteria</b>	<b>Sampling percentages for low risk proposals under new criteria</b>
\$1 million or less	33% <sup>a</sup>	1%
>\$1 million to \$15 million	33% <sup>a</sup>	5% <sup>b</sup>
>\$15 million to \$50 million	All proposals were audited	5% <sup>b</sup>
>\$50 million to \$100 million	All proposals were audited	10%
>\$100 million to \$250 million	All proposals were audited	20%
More than \$250 million	All proposals were audited	All proposals will be audited

Source: GAO analysis of DCAA procedures.

<sup>a</sup>Under the previous criteria, sampling percentages were 33 percent for all proposals \$15 million or less, not separately for the two categories (\$1 million or less; >\$1 million to \$15 million).

<sup>b</sup>Under the new criteria, sampling percentages are 5 percent for all proposals from greater than \$1 million to \$50 million, not separately for the two categories (>\$1 million to \$15 million; >\$15 million to \$50 million).

The DCAA’s leadership also noted that multi-year auditing, which allowed two or more ICPs to be combined into a single audit, reduced the DCMA’s backlog of overage FPCs. As a result, multi-year audits enabled the DCAA to finalize 1,232 ICPs in FY2015, and 1,536 ICPs in FY2016. These figures represented approximately 13% and 19% of the total number of ICPs closed in those respective years.

Our examination of organizational priorities within the context of the DCMA and the DCAA reveals a critical interplay that significantly impacted the DCMA’s FPC closeout process. The distinctive roles played by these agencies, while complementary, involved misaligned priorities and procedural conflicts that resulted in closeout delays, communication gaps, and administrative burdens on contractors, all of which contributed to delaying the FPC closeout process. It is evident that achieving harmony in organizational priorities between the DCMA and the DCAA is imperative for streamlining the FPC closeout process and reducing backlogs.

## **C. INTERNAL PROCEDURES**

In the landscape of federal contract closeout, organizational priorities are not the sole determinants of success. Equally crucial are the internal procedures followed by key stakeholders involved in the process. The efficiency and effectiveness of contract closeout hinge on the alignment of these internal procedures, as they dictate how and when tasks are executed, monitored, and streamlined. This section explores the significance of internal procedures, their role in the DCMA's FPC closeout process, and the implications of misalignment between the procedures of the DCMA and the DCAA. Through an examination of historical data and relevant literature, it becomes apparent that the harmony of internal procedures is as vital as synchronized priorities are to achieving timely and efficient FPC closeouts.

### **1. DCMA Quick Closeout Procedures**

The utilization of QCO procedures can greatly reduce the backlog of overage contracts awaiting closeout. However, certain criteria must be met before implementing this strategy. As stated in FAR 42.708 (2023), which authorizes quick closeout procedures, the contracting officer responsible for contract closeout has the authority to conduct negotiations for the settlement of direct and indirect costs related to a specific contract, task order, or delivery order. These negotiations can take place before “the determination of the final direct costs and indirect rates” outlined in FAR 42.705. However, it's important to note that the total unsettled direct and indirect costs must not exceed either \$1 million or 10% of the total contract, task order, or delivery order amount, whichever amount is lower. In conjunction with FAR guidelines, “The contracting officer also must perform a risk assessment and determine that the use of the quick closeout procedure is appropriate and consider such factors as the contractor's accounting, estimating, and purchasing systems, and any concerns of cognizant DCAA auditors” (DiNapoli et al., 2012, p. 9).

According to the DCMA Manual (MAN) (2019), the Quick Closeout (QCO) process is considered an alternative to keeping contracts open until the final settlement of indirect cost rates is accomplished. “When it becomes apparent that there will be a delay in the settlement of final indirect rates, it is recommended that the ACO utilize QCO to the

maximum extent possible” (DCMA, 2019, p. 43). The DCMA-MAN further clarifies that in accordance with FAR 42.708, QCO procedures, including the QCO class deviation or the low value/low risk QCO initiative, may be applied when the contract has reached physical completion, and both the direct and indirect costs associated with it are relatively insignificant.

Three specific policy changes improve the DCMA’s ability to reduce the FPC backlog using QCO procedures.

- DCMA Memorandum 15-215 (2015), *Disposition of Incurred Cost Actions Seven (7) Years or Older*, offers guidance regarding the handling of unsettled rates for fiscal years that are seven (7) years or more beyond the date when the final ICP was submitted or should have been submitted. This policy grants authority to ACOs to establish final indirect cost rates for all significantly overdue FCPs, except for those that are involved in litigation or are under investigation.
- To alleviate the issue of overage contracts, *DCMA Quick-Closeout Procedure Class Deviation* (DCMA, 2017), streamlines the QCO process for DCMA’s ACOs by “removing requirements to obtain an audit report or low-risk adequacy memorandum from the DCAA prior to settling QCO rates” (p. 1). More significantly, it grants ACOs the authorization to conclude final overhead rates and complete the closeout process for physically completed contracts, regardless of their dollar value or the percentage of unsettled direct and indirect costs that can be attributed to these contracts.
- The 2017 class deviation is later accompanied by DCMA Memorandum 18-097, *Low Risk Quick Closeout Initiative*, which authorizes ACOs to utilize the contractor’s final submitted ICP rates as quick closeout rates to close physically completed contracts with a total amount of unsettled direct and indirect costs less than \$750,000 (DCMA, 2018, p. 1).

Each of these policy updates streamline the DCMA’s FPC closeout process using QCO procedures. Figure 10 outlines key actions by the DCMA to reduce the backlog of overage FPCs.

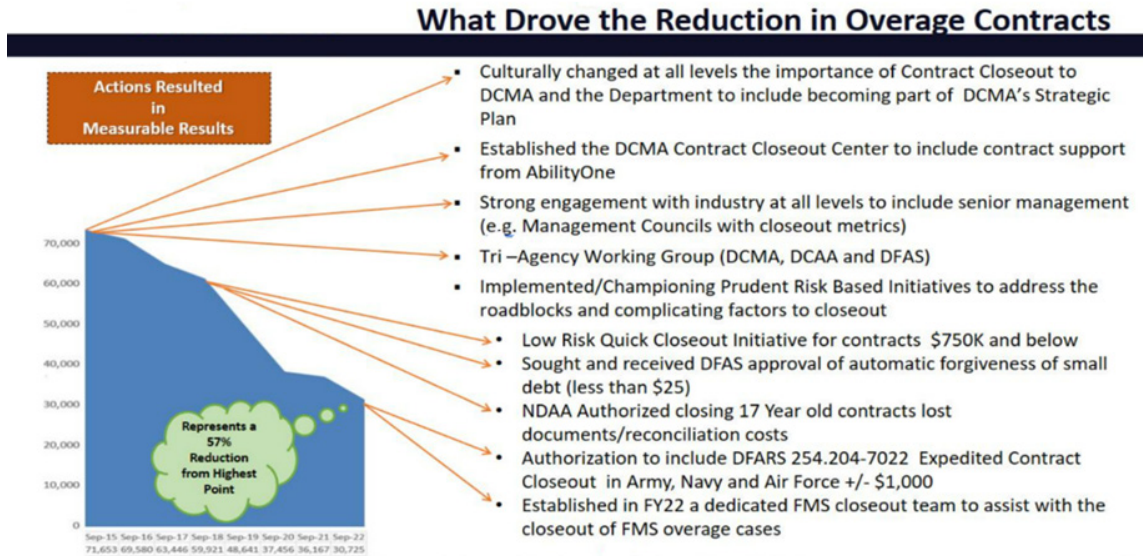


Figure 10. Driving Factors for Reduction in Overage Contracts. Source: DCMA Director (personal communication, January 23, 2023, slide 5).

## 2. DCAA Incurred Cost Proposal Audits

The DCAA’s FAR-designated role as primary auditor of defense contracts places the organization in a unique position that directly influences the ability of all DOD contracting activities to perform contract closeout actions within the time frames set by FAR 4.804-1(a). Delays, which result in a backlog of ICP audits at the DCAA level, therefore, become detrimental to the DCAA’s customers’ ability to successfully close FPCs within FAR timelines. Delays in the completion of an incurred cost audit by the DCAA can have adverse consequences on subsequent contracting actions downstream. To illustrate, contracting officers often find themselves unable to close many FPCs because the incurred cost rates provided by the contractor have not undergone DCAA audit scrutiny. Consequently, contract funding may also face expiration due to the DCAA’s inability to conclude incurred cost audits within a reasonable timeframe. (IG, DOD, 2014).

With these issues in play, it becomes evident that the DCAA's backlog of contractor ICP audits directly impacts the timely closeout of defense FPCs. In fact, agency officials identified delayed DCAA audits of contractors' ICPs as a primary factor in closing out FPCs (DiNapoli, 2017). As of the conclusion of FY2011, the DCAA was burdened with a backlog of around 25,000 incurred cost audits, with some audits dating as far back as 1996 (DiNapoli et al., 2012).

The DCAA's mission is to conduct the essential audits of contractor proposals for DOD components that are responsible for negotiating, administering, and resolving contracts and subcontracts (Bales, 2017). The DCAA's responsibilities include performing audits of submitted contractor ICPs to ensure all incurred direct and indirect costs submitted by contractors are allowable, allocable, and reasonable—information that contracting offices need to close FPCs (DiNapoli et al., 2012).

Before FPCs can be closed, contracting officers must establish final cost rates. Indirect cost rates function as a method to determine the share of overhead expenses, like a contractor's administrative costs, that are allocable to a particular contract. (DiNapoli, 2017). This audit process does not entail a one-to-one correspondence between an audit of submitted contractor ICPs and an individual contract. Instead, within a single fiscal year, a contractor may accumulate costs on multiple FPCs, and all of these contracts are encompassed in the submitted proposal. The total dollar value of the proposal, known as the ADV, is calculated as the sum of all the costs associated with FPCs for that contractor throughout the fiscal year (DiNapoli et al., 2012).

Another nuanced factor in the DCAA's ICP audit process is that the periods of performance of contracts may also span multiple fiscal years. To close a single FPC, this feature increases the need for additional audits of multiple fiscal year ICPs from a contractor. Furthermore, when a contractor's ICP is deemed inadequate (e.g., the proposal contains incomplete information or information errors, is not certified by the contractor, or for various other administrative reasons), revisions and resubmissions may be required. This process may take several iterations before the proposal is deemed adequate (see Figure 11), resulting in further delays that compound the challenges of FPC closeout.

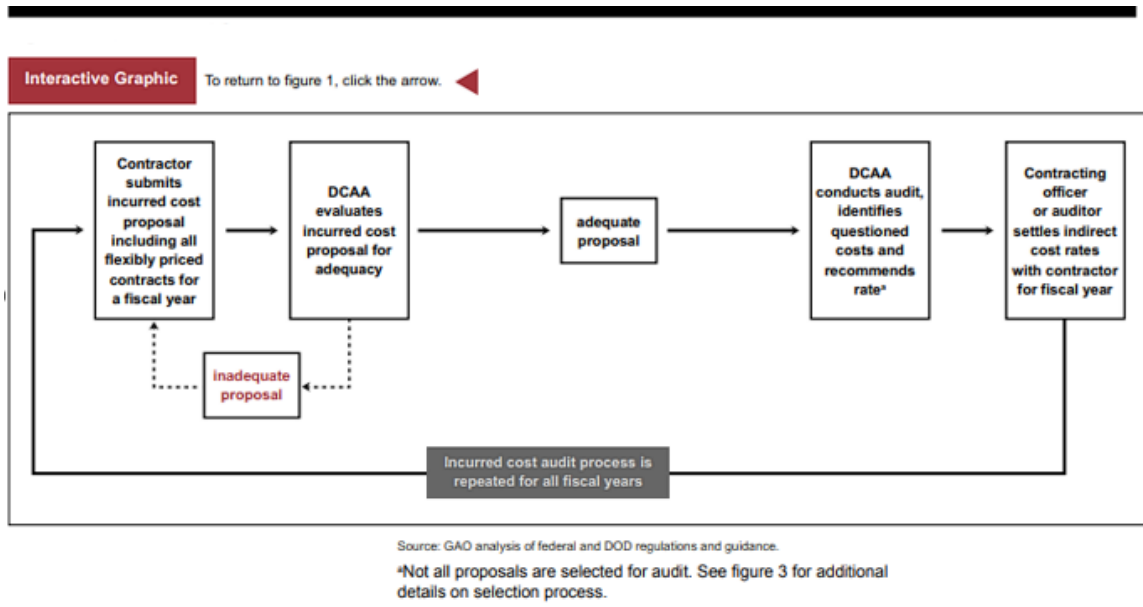


Figure 11. Incurred Cost Audit Process. Source: DiNapoli et al. (2012).

In 2011, it was acknowledged by the DCAA that their staff capacity was insufficient to handle the required number of audits. Consequently, they reported a de-prioritization of ICP audits, citing that forward pricing audits offered greater financial benefits (DiNapoli et al., 2012). To find a better approach to this problem, the DCAA determined how much money was spent performing different audits (e.g., incurred cost audits and forward pricing audits) versus how much money was saved or recovered from each type of audit. (DiNapoli et al., 2012). The analysis revealed a lower financial benefit from ICP audits below \$1 million. This led the DCAA to develop a risk-based audit procedure with updates that enabled the DCAA to reduce its ICP audit workload, and ultimately, reduce the ICP audit backlog to acceptable levels.

In 2012, the DCAA introduced a risk-based approach which involved increasing the ADV threshold for mandatory ICP audits, altering the criteria for classifying an ICP as high-risk, reducing the selection rate of low-risk ICPs for random DCAA audits, and discontinuing additional reviews of ICPs not chosen for a DCAA audit (DiNapoli et al., 2012). The ultimate purpose of the DCAA’s risk-based initiative was to decrease the number of audits conducted, which would, thereby, reduce the ICP audit backlog.



The first implementation measure of the DCAA’s risk-based initiative raised the ADV threshold from \$15 million to \$250 million, meaning that ICPs below the new dollar value threshold would not be audited by a DCAA auditor unless they were randomly selected for audit. As showed in Table 4, this change immediately decreased the number of required high-risk ICP audits from 5,194 to 659 ICPs, based on the backlog at the end of FY2011 (DiNapoli et al., 2012, p. 18).

Table 4. Incurred Cost Audit Backlog as of End of Fiscal Year 2011. Source: DiNapoli et al. (2012).

<b>Auditable dollar value</b>	<b>Number of proposals<sup>a</sup></b>	<b>Total auditable dollar value (in billions)</b>
\$1 million or less	9,040	\$4.0
>\$1 million to \$15 million	10,488	\$48.8
>\$15 million to \$50 million	2,884	\$71.0
>\$50 million to \$100 million	945	\$56.4
>\$100 million to \$250 million	706	\$79.8
More than \$250 million	659	\$313.4
<b>Total</b>	<b>24,722</b>	<b>\$573.3</b>

Source: DCAA.  
<sup>a</sup>Includes 2,431 non-DOD proposals. DCAA conducts audits on a reimbursable basis for non-DOD agencies, and is working with these agencies to determine their level of participation in the initiative. According to DCAA, the backlog includes all proposals that are due to be audited, whether they have been submitted to DCAA by the contractor or not, and whether they have been determined adequate or not.

To decrease the quantity of contractor proposals deemed high-risk, the DCAA’s second implementation measure of its risk-based initiative revised two of the three criteria used to determine whether an ICP under the \$250 million ADV is low-risk (DiNapoli et al., 2012). For example, under the old criteria, contractors were required to have a DCAA auditors within the past three years, as shown in Table 5. If the contractor did not have a DCAA audit within the past three years, it was deemed high risk even if the ADV was below the ADV threshold. With the updated guidelines, the deadline for completing the final audit on ICPs valued at or below \$100 million was removed. Instead, the requirement became that the contractor had at least one ICP audit, regardless of the time frame (DiNapoli et al., 2012, p 14). ICPs valued between \$100 million and \$250 million still required one incurred cost audit within the past three years.

Table 5. Key Changes to DCAA’s Incurred Cost Audit Low-Risk Criteria. Source: DiNapoli et al. (2012).

**Table 2: Key Changes to DCAA’s Incurred Cost Audit Low Risk Criteria**

<b>Risk factor</b>	<b>Previous criteria (applied to proposals under \$15 million ADV)</b>	<b>Revised criteria (applied to proposals under \$250 million ADV)</b>
History of incurred cost audits	At least one incurred cost audit every 3 years	At least one incurred cost audit <sup>a</sup>
Previous questioned costs	Below \$10,000	Below thresholds ranging from \$15,000 to \$100,000 based on ADV
Audit leads or other significant risks	No relevant risk factors	No changes

Source: GAO analysis of DCAA guidance and documentation.

<sup>a</sup>Proposals with an ADV of greater than \$100 million to \$250 million must have an incurred cost audit at least once every three years. For all other proposals, auditors will rely on their professional judgment to determine if a contractor’s prior incurred cost audit history is sufficient.

The third implementation measure of the DCAA’s risk-based initiative reduced the random sampling percentage for low-risk ICPs from 33% to between 1% and 20%, depending on the total ADV of a contractor (see Table 6). This sampling change led to substantial reductions in the resulting audit workload percentage, as shown in Table 7. To quantify the reduction, we calculate the percent change in required ICP audits using the formula  $(NEW-OLD)/NEW * 100$ . Applying this formula reveals the third implementation delivered the largest decrease to the DCAA’s ICP audit workload. Specifically, the reduced sampling percentages produced significantly fewer required audits. By substantially decreasing the number of required ICP audits through lower sampling rates, this procedural change provided major relief for the DCAA’s constrained audit capacity. The third implementation measure had the biggest impact on reducing the DCAA’s audit workload.

Table 6. Percentage of Proposals Sampled Under Old and New Procedures. Source: DiNapoli et al. (2012).

<b>Auditable dollar value</b>	<b>Sampling percentages for low risk proposals under previous criteria</b>	<b>Sampling percentages for low risk proposals under new criteria</b>
\$1 million or less	33% <sup>a</sup>	1%
>\$1 million to \$15 million	33% <sup>a</sup>	5% <sup>b</sup>
>\$15 million to \$50 million	All proposals were audited	5% <sup>b</sup>
>\$50 million to \$100 million	All proposals were audited	10%
>\$100 million to \$250 million	All proposals were audited	20%
More than \$250 million	All proposals were audited	All proposals will be audited

Source: GAO analysis of DCAA procedures.

<sup>a</sup>Under the previous criteria, sampling percentages were 33 percent for all proposals \$15 million or less, not separately for the two categories (\$1 million or less; >\$1 million to \$15 million).

<sup>b</sup>Under the new criteria, sampling percentages are 5 percent for all proposals from greater than \$1 million to \$50 million, not separately for the two categories (>\$1 million to \$15 million; >\$15 million to \$50 million).

Table 7. Percentage Reduction of Proposals Sampled Under Old and New Procedures.

**Calculated ICP Audit Workload Reduction**

<u>ADV</u>	<u>Old %</u>	<u>New %</u>	<u>% Reduction</u>
= \$1M or less	33%	1%	-97%
> \$1M to \$15M	33%	5%	-85%
> \$15M to \$50M	All	5%	-95%
> \$50M to \$100M	All	10%	-90%
> \$100M to \$250M	All	20%	-80%

The fourth implementation measure of the DCAA’s risk-based initiative removed any need for the DCAA to audit low-risk ICPs that were also not selected using the new sampling criteria and percentages. Previously, any proposals that were not chosen for an audit were still subjected to a desk review conducted by a DCAA auditor. Desk reviews involved assessing proposals for any abnormal charges, deviations from proposals of the previous year, and various other considerations (DiNapoli et al., 2012). Under the revised procedures (shown in Figure 12), which removed the DCAA’s required desk review of low-risk ICPs, DCAA auditors issued low risk memorandums (LRMs) to the contracting

officers, empowering administrative contracting officers (ACOs) to with the authority to determine contractors’ final indirect cost rates. This allowed ACOs to expediently proceed with closing more contracts (DiNapoli et al., 2012).

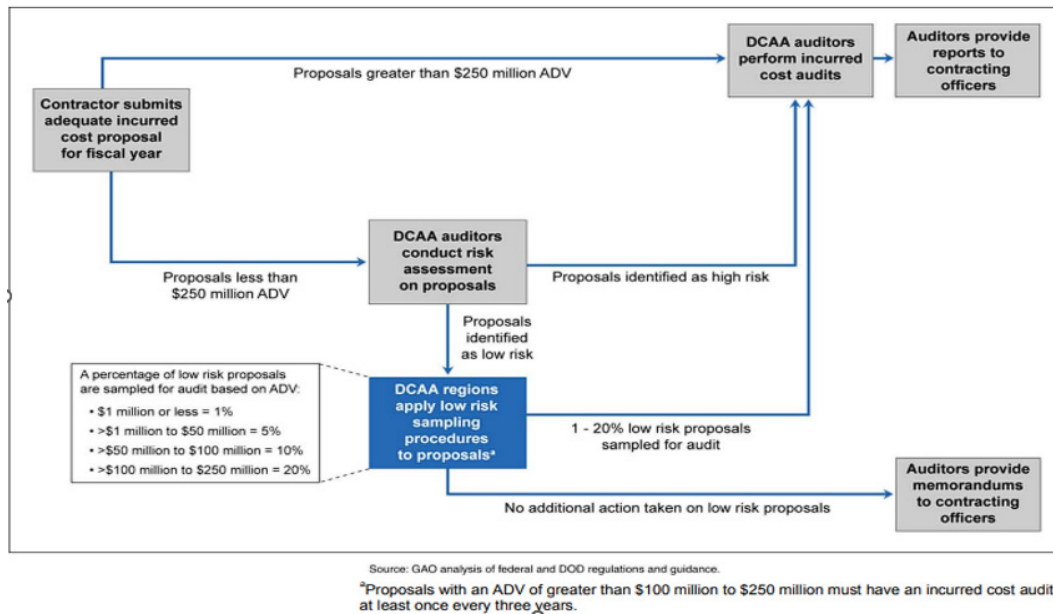


Figure 12. DCAA’s Revised Incurred Cost Audit Procedures. Source: DiNapoli et al. (2012).

#### D. SYSTEMIC DELAY

Our research team defines systemic delay as a disruption that hinders the efficient flow of tasks and causes bottlenecks in a system’s output. This delay does not occur as an isolated incident; rather, it stems from disunity between interdependent processes and procedures within a system. Ultimately, a systemic delay impedes the efficient flow of tasks and results in bottlenecks that reduce the overall functionality of a system. Resolving systemic delay often requires a comprehensive approach that addresses the underlying causes, streamlines or simplifies processes, and enhances coordination among involved participants in the system.

In the context of defense contract closeout, systemic delay presents a particularly critical role. The efficient and timely closeout of FPCs is not just an administrative task; it

impacts resource allocation, operational efficiency, and financial management across the DOD. In the case of the DCMA’s MWI, misaligned organizational priorities and conflicting procedures with the DCAA created a deleterious effect on the DCMA’s overage FPC closeout process. This section analyzes how the DCAA’s ICP audit backlog created a systemic delay in the DCMA’s FPC closeout process.

The DCMA’s identification, in 2012, of an internal weakness in its contract closeout capability ignited the agency to establish the MWI with a corrective action plan to address the backlog of overage contracts that grew from 28,966 contracts in FY2012 to a peak backlog of 71,653 contracts in FY2015 (DCMA, n.d.). Shown in Figure 13, the DCMA identified three specific root causes for the self-assessed weakness:

- The DCAA shifted focus away from ICP audits to focus on forward pricing rate proposal (FPRP) audits for newly awarded contracts,
- The DCMA focused on other audit priorities, and
- The DCAA’s closeout manpower staff was diminished.

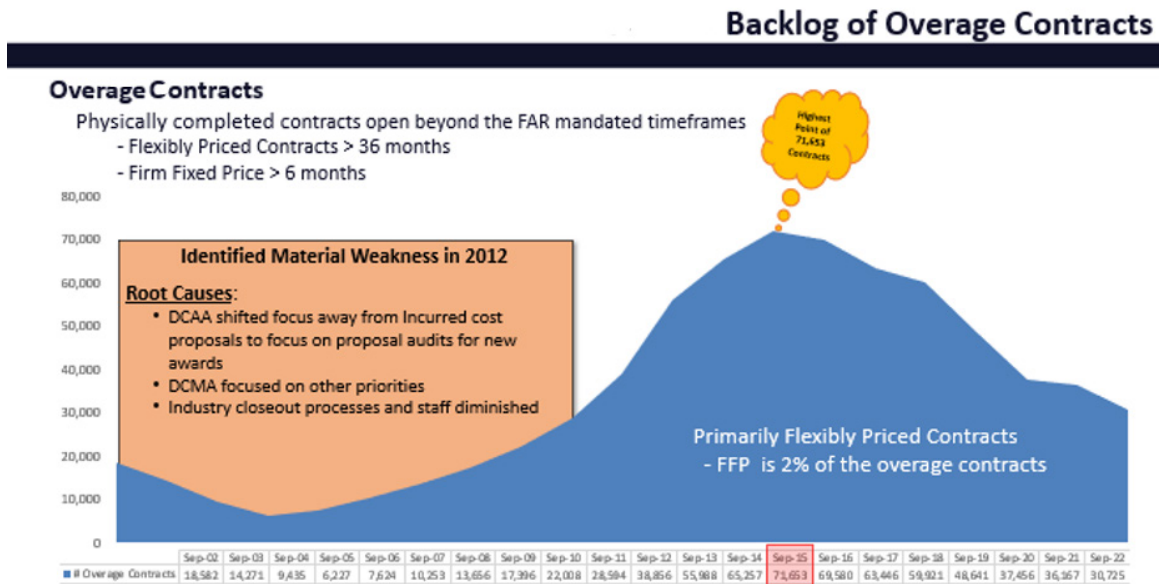


Figure 13. DCMA Material Weakness Root Causes. Source: DCMA Director (PowerPoint slides, January 23, 2023, slide 4).

Basically, the DCMA's FPC closeout process was directly dependent on the DCAA's ICP audit performance—the first root cause of the DCMA's FPC closeout backlog. This relationship, marked by the DCAA's low prioritization of ICP audits (DiNapoli et al., 2012), deepened the DCMA's backlog of overage FPCs. As a result, DCMA's backlog of contracts awaiting closeout, 98% (70,560) of which were FPCs, peaked at nearly 72,000 contracts (DCMA, n.d.).

One of the primary factors contributing to the systemic delay of FPC closeouts stemmed from DCAA's strategic shift away from prioritizing ICP audits (DCMA, 2023). The consequences of this shift in focus were twofold:

- First, it delayed thousands of ICP audits and postponed the DCMA's ability to use DCAA audit findings and negotiate final costs with contractors; a required step for closing FPCs.
- Second, it assigned higher prioritization to forward pricing rate proposal (FPRP) audits for newly awarded contracts because those audits provided the DCAA with a higher return on investment.

This inevitably left the DCMA's FPCs lingering in the ICP audit queue for an average of 885 days (about 2.5 years) from when a contractor submitted an adequate ICP to when the audit was completed (DiNapoli, 2017). The DCAA's organizational priority of assigning higher importance to FPRP audits over ICP audits contributed substantially to the DCMA's deepening backlog of overage FPCs awaiting administrative closeout.

In addition to the DCAA's strategic prioritization of FPRP audits over ICP audits, the ADV threshold used to classify contracts as high risk was set at \$15 million before the OUSD [AT&L] issued Class Deviation 2012-O0013, mentioned earlier in this chapter. This ADV threshold value caused a significant amount of the DCMA's FPCs to be classified as high risk and require a DCAA audit in accordance with FAR 4.804-5(a)(12), 42.705-1(b)(2), and 42.705-2(b)(2)(i). The purpose of the ICP audit process is to safeguard the government against unauthorized costs presented in contractors' cost proposals. However, the DCAA's ability to conduct these audits was significantly overwhelmed by the increasing audit workload. As a result, in the FY2016 National Defense Authorization

Act (NDAA), Congress mandated that the DCAA halt its audits of non-DOD entities until its backlog of ICP audits was diminished to a duration of less than 18 months (DiNapoli, 2017).

The DCMA and the DCAA jointly identified a list of indirect rate proposals that, if audited and completed, had the potential to facilitate the closeout of most of the DCMA's FPCs (DCMA, n.d.). This early recognition highlighted the significance DCAA ICP audits played in the DCMA's FPC closeout process. Later in FY2012, the issuance of a class deviation memo by the Director of the Defense Procurement and Acquisition Policy (DPAP), now titled Defense Pricing and Contracting (DPC), authorized contracting officers to utilize either a DCAA audit report or an adequacy review memo to meet the FAR's contract audit requirement (OUSD[AT&L], 2012). This policy decision allowed the DCAA to implement a low-risk sampling plan to address its substantial backlog of unaudited ICPs.

## **E. SUMMARY**

This chapter analyzes how misaligned organizational priorities and procedures between two major entities—the DCMA and the DCAA—create a systemic delay in the DCMA's FPC closeout process; ultimately, this leads to a backlog of overage FPCs awaiting closeout. Our analysis goes deeper to identify specific policy updates implemented by the DCMA's MWI that indicate increased prioritization of the contract closeout process and improved interagency collaboration efforts by both organizations which culminate in a reduced backlog of overage FPCs awaiting closeout.

The next chapter presents our study's findings to answer the first two research questions.

## V. PRESENTATION AND DISCUSSION OF FINDINGS

In this chapter, our findings are presented to answer the first two research questions. Each finding answers what actions the DCMA took to reduce the backlog of FPCs awaiting administrative closeout. Next, the findings and relevant data are used to determine how effective the DCMA's actions were to reduce the backlog of FPCs.

### A. FINDINGS

Our case study reveals seven findings to answer the first research question. Conclusions are drawn to answer the second research question.

1. The DCAA's delayed ICP audits exacerbated the DCMA's FPC closeout backlog.
2. The DCMA's use of QCO and LRQCO procedures contributed to reducing the FCP closeout backlog.
3. DCMA Class Deviation 17-742 and FY2017 NDAA updates enabled the DCMA to reduce the FCP closeout backlog.

The DCAA's strategic shift away from prioritizing ICP audits (DCMA Director, PowerPoint slides, January 23, 2023, slide 4) negatively impacted the DCMA's FPC closeout process because it impeded ACOs from settling final cost rates with contractors. As a result, FPCs aged to exceed FAR 4.804-5 timelines, and in many cases, obligated contract funds expired. By the end of FY2011, the DCAA's audit backlog spiked to approximately 25,000 incurred cost audits (DiNapoli et al., 2012). As a result, in FY2012, the DCMA's MWI was erected and identified the contract closeout process as a material weakness with a total of 28,966 overage contracts awaiting closeout (DCMA, n.d.). By FY2015, the DCMA's closeout backlog grew to approximately 72,000 overage contracts. This finding is substantiated by the DCMA's corrective action plan (see the appendix) that indicates the most substantial systemic delay within the contract closeout process stems from the DCAA's backlog of ICP audits.



- **RQ#1:** What steps did the DCMA take to reduce the backlog of overage FPCs awaiting closeout?

The DCMA elevated the priority of contract closeout in its strategic plan (DCMA Director, personal communication, 2023, slide 5). This shift in organizational culture, and policy updates enacted through the FY2017 NDAA, paved the way for subsequent updates to the DCMA's closeout procedures and its partnership with the DCAA.

As a corrective milestone in the MWI, the DCMA examined its internal procedures for opportunities to implement contract closeout policy updates that gave ACOs more power to complete the FPC closeout process. DCMA Memorandum 15-210 (2015) encouraged ACOs to utilize QCO procedures to establish final indirect cost rates for ICPs with unsettled rates for seven years or more after the date when the proposal was submitted, or supposed to be submitted. This procedural update outlined scenario-based closeout strategies that included authorization to unilaterally set indirect rates, given certain conditions were met. Two years later, DCMA Memorandum 17-742 (2017) instituted a class deviation that streamlined the QCO process for ACOs even more when it removed requirements to obtain an audit report or an LRM from the DCAA prior to settling QCO rates. Additionally, this change to the DCMA's QCO procedures "...authorized ACOs to settle final overhead rates and close any and all physically complete contracts regardless of dollar value or the percent of unsettled direct and indirect costs allocable to the contracts" (DCMA, 2017, p. 1).

Another critical enabler for the DCMA's backlog reduction effort was Class Deviation 2018-O0014, issued by the Undersecretary of Defense, Acquisition and Sustainment (OUSD [A&S]) that implemented section 836 of the NDAA for FY2017. This policy update gave DCMA ACOs more authority to close contracts, or groups of contracts at least 17 fiscal years old, through the "issuance of one or more modifications to such contracts without completing a reconciliation audit or other corrective action in accordance with FAR 4.804-5" given specific criteria were met (OUSD [A&S], 2018, p. 1).

- **RQ#2:** How effective were the DCMA's processes at returning the contract closeout backlog to an acceptable level?

The data available to our research team was limited, making it challenging to correlate specific FPC closeout percentages with distinct administrative actions or ascertain the precise savings attributed to the DCMA’s adoption of QCO/LRQCO procedures, the updates in the FY2017 NDAA policy, and the 2018 class deviation. While it was not possible to obtain specific data, a 2020 internal memorandum indicates that “increasing the use of QCO and low-risk QCO procedures” and “aggressively using the NDAA 2017/2018 Class Deviation Authority DARS 2018-O0014” (see the appendix) contributed to the DCMA’s MWI goal of reducing overage FPCs.

4. The DCMA leveraged the DCAA’s policy update in Class Deviation 2012-O0013 to reduce the closeout backlog.

Our research highlights the misaligned priorities and conflicting procedures between the DCMA and DCAA which contributed to untimely delays in FPC closeout. The DCMA prioritizes the operational aspect of contract administration. Their mission is to ensure that defense contractors deliver products and services to support military readiness and mission requirements (Kidd, 2019). The DCAA is responsible for auditing defense contracts and ensuring claimed costs of contractors are allowable, allocable, and reasonable (DiNapoli et al., 2012, p. 7). The DCAA places a high importance on the accuracy and thoroughness of financial audits. As a result, the audit process is a time-consuming task that led to the backlog of overage FPCs awaiting closeout. Procedurally, the DCAA’s financial audits are vital to the contract closeout process because FAR 4.804-5 (2023) mandates that a contract audit is completed, and the DCMA cannot proceed with the FPC closeout process until DCAA audits are completed.

- **RQ#1:** What steps did the DCMA take to reduce the backlog of overage FPCs awaiting closeout?

The DCAA implemented a policy update in Class Deviation 2012-O0013 for sampling low-risk ICPs. This policy update had a twofold effect; (1) it reduced the amount of FCPs classified as “high risk” and (2) it reduced the sampling percentage rates for FCPs classified as low risk. As previously stated in Chapter 4, the higher ADV threshold for classification as a “high-risk” contract was set at \$250M. This higher ADV threshold led

to a substantial reduction in the overall number of contracts requiring audit, as shown in Figure 12 on page 52. As mentioned above, the DCAA's audit process is time-consuming. Given that level of complexity, the policy update from the DCAA's class deviation reduced the volume of the DCAA's audit workload; this complemented the DCAA's audit capacity issue, and reciprocally, redirected more control to DCMA ACOs to close overage FPCs. For example, the class deviation gave ACOs authority to use adequacy reviews in place of the DCAA's audit report when contracts meet specific criteria. Moreover, for low-risk FPCs under the \$250M ADV not chosen for audit from a sampled percentage of contracts, the class deviation also gave ACOs the ability to conduct desk reviews of unsettled costs and issue LRMs in place of the DCAA audit report. Overall, the updated ADV thresholds and audit sampling percentages reduced the input volume of queued ICP audits at the DCAA. Recognizing this opportunity, the DCMA screened, identified, and closed more overage FPCs under its control.

- **RQ#2:** How effective were the DCMA's processes at returning the contract closeout backlog to an acceptable level?

Class Deviation 2012-00013 tremendously reduced the number of overage FPCs classified as high risk, and low-risk FPCs that required an ICP audit. By increasing the ADV threshold and diminishing audit sampling percentages for low-risk FPCs, this policy revision alleviated the DCAA's audit obligations and enabled DCMA ACOs to immediately close more FPCs. This policy change is likely the largest factor in the DCMA's backlog reduction, considering ICP audits were identified as the primary root cause in the corrective action plan (refer to the appendix). The estimated decrease in the DCAA's audit workload is depicted in Table 7 on page 52. We deduce that these estimated reductions in the DCAA's audit workload equate to corresponding increases of the same magnitude in the DCMA's potential to close FPCs.

5. The DCMA elevated the contract closeout process to a position of strategic importance in the DCMA's organizational priorities.

6. The DCMA increased its closeout throughput by establishing CCCs that were dedicated to the MWI's contract closeout objective.
7. The DCMA formed tri-working groups with the DCAA and DFAS to increase FPC closeout efficiency.

Overage contracts have been a cyclical issue in defense contracting for as long as the DOD has utilized contracting as an acquisition instrument. In the past, the DCMA—a vital player in the federal government's contracting process—used temporary solutions to resolve contract closeout backlogs. Empowered by a rich history of providing contract administration services and facing several challenges to meet FAR requirements, the DCMA has a deep understanding of what actions are necessary to reduce FPC backlogs. Additionally, the DCMA was familiar with successful organizational changes carried out by other contracting entities and decided it was time to take a new approach.

- **RQ#1:** What steps did the DCMA take to reduce the backlog of overage FPCs awaiting closeout?

The DCMA adopted a multi-dimensional strategy to address FPC closeouts. This involved prioritizing contract closeout in its strategic plan, a significant cultural shift. Actions included the establishment of CCCs to increase contract closeout throughput, creation of a tri-organizational working group align contract closeout priorities across organizational boundaries, and the introduction of internal metrics. These metrics aimed to quantify the backlog in terms of number and monetary value, recognize closeout trends and relate them to procedural adjustments, and ultimately diminish the FPC backlog.

From the body of literature, we noted that the establishment of contract closeout teams was commonly a temporary strategy adopted by federal contracting organizations to reduce FPC backlogs. In this case, the DCMA staffed CCCs as a permanent solution. These CCCs provided oversight to FPCs with settled rates still open but with the potential to be closed. They also served as hubs for overage contract closeout functions, staffed with dedicated government and contracted AbilityOne personnel. Ultimately, the CCCs allowed the DCMA to streamline and expedite the FPC closeout process.

The second prong of the DCMA's approach was to form a tri-organizational working group with the DCAA and DFAS, all of which play vital roles in federal contracting. This working group was assembled to tackle the issue of delayed ICP audits, protect funds from being canceled, and accomplish FPC closeout objectives. On a monthly basis, this team addressed contract closeout and data reconnaissance actions. The cultural shift in all three organizations enabled the DCMA's MWI to aggressively reduce the FCP backlog.

The final prong of the DCMA's approach was to institute metrics that allow decisionmakers to measure FPC closeout progress, recognize and correlate patterns in closeout data, and manage procedures to influence the desired outcomes. Two metrics were developed with annual goals: (1) Metric 1—reduce the number of contracts awaiting closeout by 20%, and (2) Metric 2—reduce the total obligated dollar value of contracts awaiting closeout by 20%. According to the DCMA's corrective action plan (shown in the appendix), the initial baseline for the two metrics was established in FY2016 when the closeout backlog was approximately 72,000. Through the next five years, the DCMA's MWI reset the baseline each year to track the organization's closeout progress and annually achieve its strategic goals.

- **RQ#2:** How effective were the DCMA's processes at returning the contract closeout backlog to an acceptable level?

The organizational shift that led to the elevated priority of contract closeout was brought about by the establishment of CCCs, the formation of a tri-organizational working group, and the introduction of metrics to measure the effects on the backlogged contracts. This three-pronged approach allowed DCMA to decrease the number of overaged contracts to roughly 39,000 (-43%) by FY2020.

By using the CCC, the tri-working group, and maintaining contract closeout metrics, DCMA reduced the contract closeout backlog by nearly 45%. The changes that were implemented were not earth-shattering, but they reduced the backlog of overage contracts and identified ULO funds to reallocate to other contracts.

## **B. SUMMARY**

In this chapter, the findings are presented and the first two research questions are answered based on the relevant data from our case study. The next chapter provides conclusions, recommended contract closeout practices to answer the third research question, and recommended areas for further research.

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## VI. CONCLUSIONS AND RECOMMENDATIONS

Contracts form the backbone of government operations and enable the provision of critical resources and services to support our nation's defense and other vital missions. Within defense contracting, the contract closeout process plays a critical role to ensure efficiency, accountability, and optimal resource allocation. However, it is not uncommon for agencies to encounter challenges, such as backlogs of overage flexibly priced contracts (FPCs).

Our research addresses this critical deficiency within the defense contract closeout process. We posit that the efficient closeout of contracts is not merely an administrative task; it is a strategic imperative. The impact of FPC backlogs extends beyond paperwork; it affects resource allocation, fiscal responsibility, and the ability to embark on new contracts. Our research aims to shed light on the strategies employed by the Defense Contract Management Agency (DCMA), from FY2015 to FY2020.

In this chapter, we leverage the DCMA's case study to formulate a series of recommendations to answer our third research question. Building on this foundation, these recommendations are the result of a thorough analysis of the DCMA's successful efforts to reduce a backlog of overage FPCs. Drawing from our analysis of the DCMA's Material Weakness Initiative (MWI) data and successful closeout strategies highlighted in the literature, they serve as effective practices for defense contracting organizations to adopt when seeking to reduce and prevent FPC closeout backlogs.

Now, as we shift our focus to these essential recommendations, based on our findings from the DCMA's MWI data and successful closeout backlog reduction practices presented in the literature, we conclude that defense contracting organizations must: (1) set organizational contract closeout goals that are specific, measurable, and reported periodically, (2) establish processes that enable multiple stakeholders to monitor and be held accountable for contracts awaiting closeout, and (3) consider adding contract clauses during the pre-award phase that enable ACOs to efficiently close contracts during the post-award phase.



Following our presentation of recommendations to answer the third research question, we suggest potential areas for further research. By doing so, we aim to advance critical analysis of functional areas that enable defense contracting organizations to increase closeout efficiency.

## **A. RECOMMENDATIONS**

To answer our third research question, and based on the findings of our case study, we recommend that a defense contracting organization should:

1. Set organizational FPC closeout goals that are specific, measurable, and reported periodically.

FPC closeout is a complex process that requires efficiency and accountability of all involved stakeholders. Specific goals provide clarity on what needs to be achieved. Measurable goals enable contracting organizations to track progress and determine whether the organization is meeting its closeout targets. When goals are measurable, it becomes easier to hold individuals or teams accountable for their performance. Regular reporting creates a culture of shared responsibility and apprises all levels of management of potential opportunities or threats to the FPC closeout process.

2. With multiple entities involved in the FPC closeout process, establish a process that tracks the progress of queued FPCs awaiting closeout.

A tracking process provides visibility into the status of each contract in the queue and allows all involved entities to actively track contracts through full administrative closeout. When contracts are tracked, it becomes clear who is responsible for the next administrative action. Tracking progress also helps identify bottlenecks or delays in the closeout process. This allows upper management to effectively target and allocate available resources (e.g., manpower, funds, expertise, etc.) based on the complexity or urgency of need. A tracking process also helps ensure government contracts remain compliant with FAR time standards.

3. Consider adding contract clauses during the pre-award phase that enable ACOs to efficiently close FPC during the post-award phase.

In defense acquisitions, the planning phase sets the stage for all subsequent phases of the contracting life cycle. During this phase, contracting officers should utilize clauses that address closeout procedures which empower ACOs with the necessary authority and guidance to efficiently expedite the closeout process. For example, a clause that enables ACOs to use a contractor's previous fiscal year rates in the event that the final invoice is not submitted in a certain timeframe would incentivize the contractor to promptly submit the final invoice. Defense contracting officers should take advantage of any opportunity to insert clauses that improve closeout efficiency and which are not restricted by the FAR, or legislation.

4. Form interorganizational teams with key players from each stakeholder organization to improve FPC closeout efficiency.

Defense contracting routinely experiences delays due to misaligned priorities and conflicting procedures between multiple stakeholders. To address this issue, the DCMA formed tri-organizational working groups with key players from the DCAA and DFAS. This approach provided a platform to identify, evaluate, prioritize, and assign specific issues in the closeout process for action. The DCMA's case serves as an excellent example of how the use of interorganizational teams creates an environment that enhances communication and collaboration, and which ultimately increases effectiveness in the closeout process.

5. Use QCO procedures, when possible.

For organizations dealing with a backlog of contracts awaiting administrative closeout, QCO procedures are a valuable tool. Given that specific criteria are met, defense contracting organizations can use QCO procedures selectively for contracts that are considered low risk based on the ACO's review. QCO procedures provide ACOs a method to reduce allocated resources, facilitate prompt final payments to contractors, and reduce contract closeout times. Defense contracting organizations are encouraged to evaluate and streamline their current contract closeout process.

## **B. RECOMMENDATIONS FOR FURTHER RESEARCH**

In the course of our research, the following topics were pointed out as credible subjects for further research to improve the defense contract closeout process:

### **1. Manpower**

The focus of our research is to identify the systemic delays related to organizational priorities and internal procedures. It does not research observable shifts of manpower from contract closeout activities to contract award activities within defense contracting organizations. While this shift may have implications for the efficiency of contract closeout, its detailed exploration is beyond the scope of this study. It is crucial for defense contracting organization to strike a balance between contract award and closeout activities to maximize overall efficiency. Therefore, it is recommended that further research be conducted on organizational strategies that explore opportunities to efficiently leverage manpower in the contract closeout process.

### **2. Training**

Our case study does not endeavor to address the gaps in professional knowledge observed in a contracting workforce staffed with more junior personnel. However, it is essential to recognize the significance of these potential knowledge gaps. While training is crucial to ensure contracting personnel understand how to competently employ contracting strategies during the closeout process, our study's primary emphasis is on systemic delays resulting from misaligned organizational priorities and conflicting internal procedures. Further research should focus on training opportunities for ACOs in each of the 15 closeout steps outlined in 4.804-5 where knowledge gaps may exist. Further research on contract closeout training for contracting personnel would be useful to all contracting organizations looking to improve closeout efficiency and minimize potential delays that occur due to a lack of expertise.

### **3. Multiple Involved Organizations**

The relationships and interactions with other involved government organizations, such as the DFAS, also influence the contract closeout process. However, this research

focuses exclusively on the interactions between the DCMA and DCAA. The potential impacts of other organizations' procedures and priorities are not directly explored in this study. Further research on how to manage contract closeout with multiple involved organizations would assist contracting organizations to improve closeout efficiency.

#### **4. Internal Competition**

The competing value systems and departmental dynamics within government organizations may contribute to contract closeout challenges and reduced capacity. However, our study does not explore the nuanced influence of departmental relationships within a defense contracting organization that may impact the contract closeout process. Since internal competition for resources is a real challenge for contracting organizations, further research should be conducted that explores contract closeout tradeoffs in an organizational environment where resources are constrained.

#### **5. Legislation and Defense Federal Acquisition Regulation Supplement Updates**

Our case study analyzes the effects of legislation and acquisition policy updates on the DCAA and DCMA's organizational priorities and internal procedures. However, the scope of this research does not conduct a deep analysis of contract closeout opportunities that stem from current legislative and policy updates. Given the changing nature of acquisition regulations, further research should be conducted, iteratively, to ensure compliance with all regulatory updates that influence the contract closeout process.

#### **6. Procurement Integrated Enterprise Environment and MOCAS**

The interoperability of business systems used to manage the contracting life cycle, such as Procurement Integrated Enterprise Environment (PIEE) and MOCAS, is not a subject of focus in our research. While these systems are intended to enhance contract closeout management, further research should be conducted on how these platforms contribute to contract closeout effectiveness and improve efficiency.

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## **APPENDIX. DCMA MWI CORRECTIVE ACTION PLAN WITH FISCAL YEAR MILESTONES AND DETAILED DATA**

Owing to restrictions on document release, this appendix features a paraphrased rendition of the internal memorandum, which was disseminated following the culmination of efforts to diminish the excess overage FPC backlog under the DCMA's Material Weakness Initiative (MWI). This approach ensures adherence to the DCMA's confidentiality requirements while providing an essential understanding of the memorandum's content.

**SUBJECT: Resolution of Contract Closure Metrics**

This document records the measures implemented to address and reduce the backlog of flexibly priced contracts (FPC) in excess, which led to the OSD identifying a Material Weakness (MW) in these contracts.

The following are the actions undertaken by DCMA to rectify this issue:

The accumulation of overdue contracts primarily arose from DCAA shifting focus from auditing incurred cost proposals to new contract award proposals. The corrective actions included:

1. Collaborative efforts between DCMA and DCAA to prioritize a set of indirect rate proposals for contractors, ensuring high-priority audits.
2. A directive issued by the Director of DPAP (now DPC) on July 24, 2012, allowed contracting officers to use either a DCAA audit report or an adequacy review memo to meet audit requirements, aiding in DCAA's adoption of a low-risk sampling approach to address about 17,000 pending audits of final indirect rate (incurred cost) proposals.
3. Utilization of DCAA's low-risk memos to expedite the contract closure process.

To achieve the MW target of reducing 20% of overdue contracts from a specific baseline, the following steps were executed:

1. The creation of the Contract Closeout Center (CCC) with Government and AbilityOne staff, and the use of six Corporate Management Councils (CMCs) to address overdue FPCs, including audit timelines and final voucher package submissions.
2. Proactive application of the NDAA 2017/2018 Class Deviation Authority DARS 2018-O0014.

3. Enhanced use of quick closeout and low-risk quick closeout procedures
4. Ongoing collaboration with DCAA/DFAS to decrease the number of overdue contracts and settle indirect cost rates.
5. Introduction of a metric for the Cost & Pricing Regional Command (CPRC) to issue indirect rate agreements for settled rates.

Results achieved:

1. DCMA has successfully reduced its backlog of overdue contracts by 43.45%, from 71,653 in FY2015 to 40,515 by the end of May 2020. This reduction is significant, and the current backlog is expected to continue decreasing.
2. DCMA's ongoing alignment with DCAA/DFAS strategies, including DCAA's shift to more frequent incurred cost audits and the use of low-risk memos.
3. DCMA maintains effective control over the contract closure process, evidenced by compliance with closure procedures as verified by the Financial Improvement & Audit Remediation (FIAR) group, along with the actual reduction in overdue contracts.

Director, Contract Closeout Center

Attachment(s):

TAB A. AQ-MW-12-01 CAP-Clearing Contract Closeout Backlog  
TAB B. AQ-MW-12-01 Clearing Contract Closeout Backlog Slide

Link(s):

None



**Corrective Action Plan (CAP)**  
**UNCORRECTED (B-2) Material Weakness - Significant Deficiency - Control Deficiency**

<b>CAP Details</b>		
<b>CAP Number</b>	AQ-MW-12-01	
<b>CAP Title</b>	Clearing Contract Closeout Backlog	
<b>Year Identified</b>	2015	
<b>Description of Issue</b>	DCMA has been unable to reduce the number of overage contract closeouts from the initial FY2012 material weakness total of 28,966. The backlog has continued to grow primarily from inability to settle final overhead rates due to timeliness of incurred cost audits. At the beginning of FY2017 the number of overage contracts was 72,682, including Special Programs. The root cause of the overage contracts backlog stemmed from DCAA's shift from auditing the incurred costs' proposals to reviewing the new contract awards' proposals.	
<b>How is Success Measured</b>	Contract closeout of flexibly priced contracts reduced by 20% and there are no more than 350 overage fixed price contract closeouts.	
<b>Deficiency Type (Drop-Down)</b>	Material Weakness	
<b>CAP Target Completion Date</b>	Q4 FY2020	
<b>Corrective Actions Pending</b>		
<b>Target Correction Date</b>	<b>Planned Activity</b>	<b>Status</b>
Q3 FY2012	DCMA identified w/DCAA a list of indirect rate proposals which if completed, would close most contracts	Complete
Q4 FY2012	On July 24, 2012, the Director of DPAP (now DPC) issued a class deviation memo authorizing the contracting officers to use either a DCAA audit report or adequacy review memo to satisfy the audit requirements. This allowed DCAA to proceed with a new low-risk sampling plan to help reduce a backlog of approximately 17,000 unaudited final indirect rate proposals (also called incurred cost proposals). Development of contract closeout training package; training deployed to GS-1102 keystones & new 1102s	Complete
Q1 FY2013	DCAA low-risk memos were also used to streamline the closeout process. Partnered w/DCAA on their sampling plan for low risk final indirect rate proposals. Initiated contract closeout blitz to close contracts where DCMA has responsibility. This enabled closure of 4,036 contracts (26% of starting population); developed 8-hr refresher contract closeout training & deployed to GS-1102 community	Complete
Q1 FY2014	The MW goal was to reduce 20% of overage flexibly priced contracts against a set baseline. Increased \$ value of proposals included in sample; created contract closeout scorecard for field commanders to see progress; partnered w/Ability one to create contract closeout teams to help support field activities; pilot program initiated in San Diego Jan 2013	Complete
Q1 FY2015	Phase 1 of new closeout group stood up at HQ Ops; gave management oversight to contracts w/settled rates still open but w/potential to be closed; 67,564 backlog	Complete
Q2 FY2015	Phase 2 stood up at Ops; interactive training to DCMAS 1102 community to include new employees and supervisors; 70,227 backlog	Complete
Q3 FY2015	Phase 3 stood up; DCMAI contract closeout team responsible for closeout of section two contracts for OCONUS; Houston OCONUS group is responsible for closeout of overage LOGCAP III/IV, AFCAP, SPAWAR, and Iraq Ranch back; 71,653	Complete
Q4 FY2015	With the resolution of DLA Aviation payment issues DCMAI will reduce overage by 49%; CCT looks forward 30-60-90 days to prevent increases in overage; Houston OCONUS group will reduce overage by 7%; reduction will be result of receiving final closing packages; As an Agency, DCMA has reduced its overage inventory by 34,197 from FY15 highest of 71,653 contracts to 37,456 contracts at the end of September 2020. The current overage inventory is manageable and will continue to decrease precipitously. DCMAS to complete FY16 strategy to identify largest groups of quick closeout.	Complete
Q1 FY2016	Ops baseline within DCMA control for FY16 is 20,194 overage w/obligated value of \$52,400,363,356; DCMA Ops has closed from baseline through Dec 2,872 cost type contracts w/obligated value of \$4,279,720,207; 71% reduction; DCMAS consolidating and scrubbing the feedback prior to sending to Cost Pricing for help; DCMAS has reduced backlog from \$4.2B to \$2.4M; 72,001 backlog	Complete
Q2 FY2016	Director was brief on metrics; metrics being tracked monthly at CMO level; 71,459 backlog	Complete
Q3 FY2016	Facilitate engagement at appropriate DFAS/DCAA levels to coordinate more overage contracts moving within DCMA control; DCMA/DCAA meeting held Apr 2016; monthly DFAS/DCMA working level group meets to address closeout and recon actions/issues; working group established to align incurred cost audits, canceling funds, and closeout priority. DCMAS closed total of 70.4% towards planned milestone; 71,300 backlog	Complete
Q4 FY2016	Initiate standup of second contract closeout center staffed w/government and ability one personnel; leverage the six corp management councils to reconcile all contracts that are overage and the timelines for audits and submission of a closeout package to include final invoice; participate in DoD wide closeout focus groups identifying opportunities for process improvement	Complete
Q1 FY2017	Reset baseline of cost type contracts under DCMA control to close by adding action remaining from FY16; FY17 goals: Flexibility priced baseline 43,075 contracts (20% reduction); fixed price baseline 1,158 (25% reduction)	Complete

Q2 FY2017	Reduced contracts within DCMA's control established FY17 baseline by 20% per year/5% per quarter for cost type contracts (obligated value and quantity) and 25% for fixed price type contracts (target Original Baseline * .5 * .25). Flexibly priced contracts baseline -43,075 kts, 2nd quarter goal 10% reduction or 4,308kts. As of 31 Mar 17, reduction of 4,652 kts or 10.80% exceeded goal of 10%. 2nd quarter goal 10% reduction or \$14,496,554,508.34. As of 31 Mar 17 achieved a reduction of \$ 11,952,404,458 or 8.24%. Agency did not meet 10% reduction by 31 Mar 17. To achieve the goal of 20% reduction by end of FY 17 the Operating Units have identified the highest obligated contracts per Unit and are targeting these contracts. The higher dollar value contracts are Reduced the contracts within DCMA's control that are in the established FY17 baseline by 20% per year/5% per quarter for cost type contracts (obligated value and quantity) and 25% for fixed price type contracts (target Original Baseline * .5 * .25). Flexibly priced contracts baseline -43,075 kts, 2nd quarter goal 10% reduction or 4,308kts. As of 31 Mar 17, reduction of 4,652 kts or 10.80% exceeded goal of 10%.	Complete
Q3 FY2017	2nd contract closeout center staffed and fully mission capable; 42 ability one FTEs; govt 54 FTEs (34 onhand); government manning shortfall due to hiring freeze	Complete
Q4 FY2017	Monthly metrics to Director; assess need to revise deviation for quick closeout; participate in implementing guidance development for use of NOAA legislation allowing closure of contracts entered into before FY00 without contract line item recon under certain circumstance	Complete
Q1 FY2018	Reset baseline; expected baseline under DCMA control will increase due to DCAAs closing the gap on open audit years	Complete
Q2 FY2018	Number of contracts has been reduced by 59%; dollar amount by 36%	Complete
Q3 FY2018	Monthly metrics to Director and ensure efforts are still being tracked at Region level	Complete
Q4 FY2018	Continued participation in DCAA engagement, CMC and DoD wide focus groups	Complete
Q1 FY2019	FY19 baseline set as follows: Reset the baseline of flexibly priced contracts under DCMA control to close by adding those actions remaining from FY 2017 to overage contracts that DCAA has completed their audit/issued rates or are in OF AS for action. It is expected baseline number under DCMA control will increase due to DCAAs closing the gap on open audit years	Complete
Q2 FY2019	Reduce contracts established in FY19 baseline by 20% per year/5% per quarter; no more than 350 fixed price contracts are overage	Complete
Q3 FY2019	Monthly metrics to Director and ensure efforts are still being tracked at Region level	Complete
Q4 FY2019	Continued participation in DCAA engagement, CMC and DoD wide focus groups	Complete. DCMA continues to quarterly engagement with DCAA to discuss various issues i.e. Incurred cost audits, subcontractor settlements, quick closeout issues, etc. that may impact closeout and to ensure that one voice of Government is presented to industry. DCMA also continues to be an active part of the CMCs and DOD wide focus groups, i.e. AIA.
Q1 FY2020	Reset baseline	Complete. The DCMA baseline has been reset with collaboration from the Regions. The DCMA Material Weakness baseline of contracts within "DCMA control" to close was published on 13 Nov 19 at 44,263 kts and an obligated value of \$179.82B. The OSD metrics are 20% reduction of the baseline for both quantity of contracts and obligated value or close 8,852 kts and reduce obligated value by \$35.96B. The fixed price contract metric remains at 350 kts. The Agency's internal goal is to reduce Metric 1 by 30% or by 13,280 kts, and Metric 2 by 22.5% or \$40.4B. Metric 3 Fixed price contract remains steady at 350. Expect to complete OSD CAP by end of FY20. Agency will continue to burndown overage to a steady state of overage (expect approximately 25K).
Q2 FY2020	Reduce contracts established in FY20 baseline by 20% per year/5% per quarter; no more than 350 fixed price contracts are overage. DCMA will continue to work to reduce the number of overage contracts to a steady state of approximately 11,000 overage contracts. In FY21, DCMA made a strategic change in focus for the CMOS to focus on closing non overage flexibly priced contracts and all fixed price contracts (with the exception of DCMA International (DCMAI)) and the Contract Lifecycle Management Center (formerly known as the Closeout Centers) will focus on closing overage contracts and DCMAI fixed price contracts. This effort will enable the Agency to close both overage contracts and contracts on time which benefit the services on both ends- reducing the backlog of overage contracts and increasing the return of excess funds for possible reuse by closing contracts on time.	Complete As of the end of Mar 2020 the Agency has achieved a completion of 16.16% or closed 7,152 kts for Metric 1 and reduced Metric 2 obligation value by 13.88% (\$25.38B. Metric 3 fixed price contracts, the Agency is currently slightly above the goal of 350 but expects to meet the goal by end of the fiscal year.
Q3 FY2020	The agency will continue to test and monitor the number of overage contracts through a monthly data pull provided by the Shared Data Warehouse for Part A Section 2 that reflect whether a DCMA administered contract is overage. If the number of overage is greater than 45,000 for 3 consecutive months a new material weakness will be identified. As DCMA's overage contracts continue to decline the Executive Director of contracts may choose to lower the 45,000 overage contracts ceiling. Monthly metrics to Director and ensure efforts are still being tracked at Region level	Ongoing. SLT and the regions are provided a monthly update of the status of progress the metrics monthly basis (usually by the 15th of the month) and the data is also posted on DCMA AQD 360 site.
Q4 FY2020	Continued participation in DCAA engagement, CMC and DoD wide focus groups	On going: Will continue to be an active participant with DCAA and all DoD wide focus groups to ensure closeout of both overage and on-time closeout of contracts. Also, in this qtr DCMA is establishing internal metrics to increase the rate of on-time closures thus reducing the number of contracts that become overage each year.

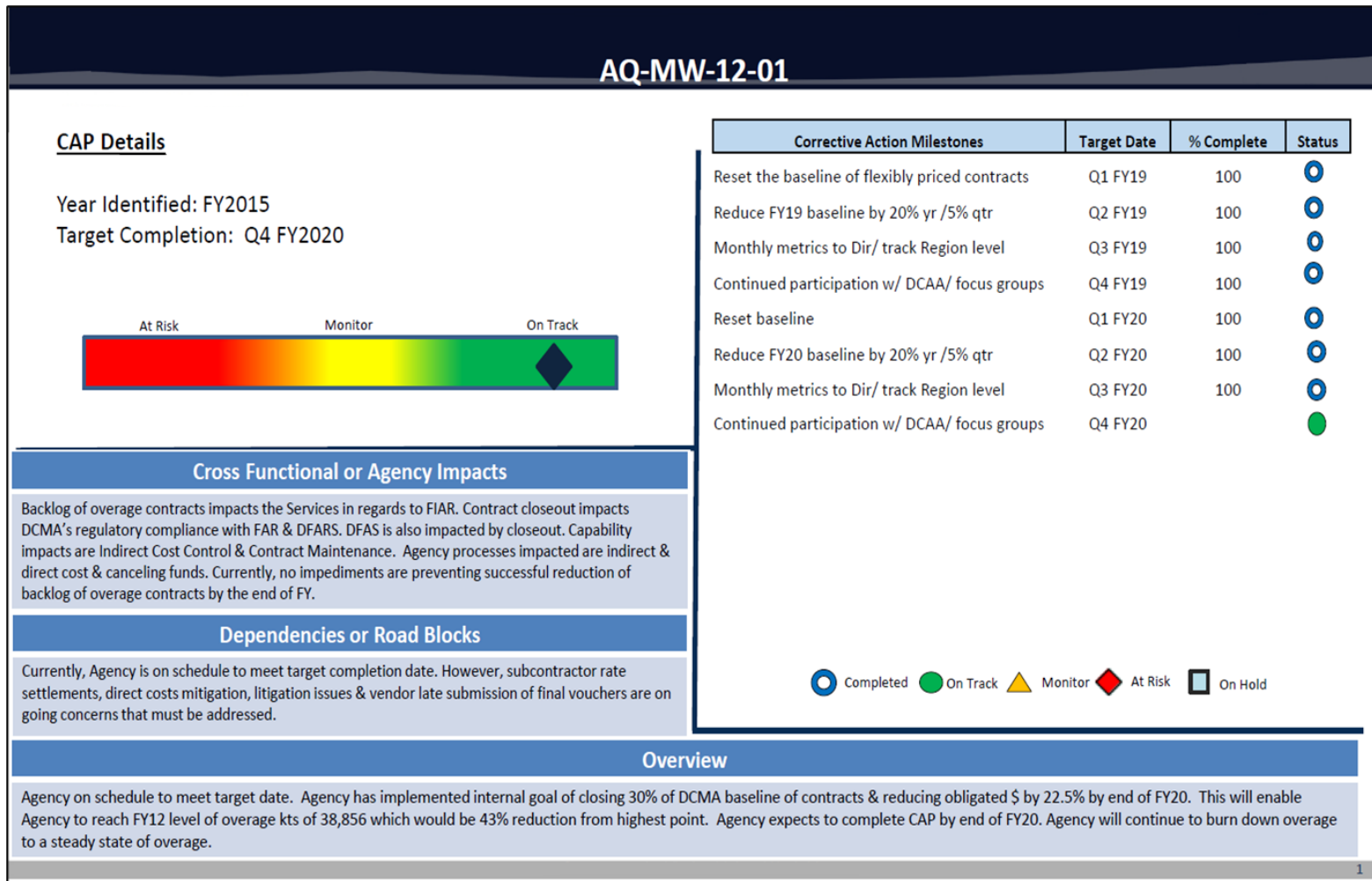


Figure 14. Information from DCMA. Adapted from DCMA personal communication, July 3, 2023.

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