

TOPIC 19

CONTRACT CLOSEOUT

Objective

To determine whether the agency uses effective and efficient practices and procedures to close contracts and de-obligate unneeded funds.

Sub-objectives

Specifically, determine whether the Agency:

1. Utilized effective and efficient policies, procedures, practices, and controls when closing contracts; and
2. Sufficiently reviewed funds remaining on physically completed contracts to determine whether they can be used on other projects.

CONTRACT CLOSEOUT

INTRODUCTION

This guide provides detailed audit steps for determining an agency's compliance with prescribed regulations and agency guidance as well as use of best practices adopted by various Federal agencies for closing prime contracts and task orders awarded under prime contracts. The guide expands upon the researchable questions associated with Closeout (Topic 19) identified in the *Contract Audit Guide Framework* that was released in 2009 by the Contracting Committee of the Federal Audit Executive Council. The framework provides a construct of issues and researchable questions to consider when planning audits or reviews of contracts. It is the Contracting Committee's intention to issue detailed audit guides for each issue identified in the framework. Audit teams are encouraged to modify the *Contract Closeout Guide* as appropriate, and to use the guide, in conjunction with other appropriate tools, to assess compliance with the Federal Acquisition Regulation Subpart 4.804 - Closeout of contract files. The guide focuses significantly on Federal Acquisition Regulation 4.804.5 - Procedures for closing out contract files. For your convenience, the guide includes relevant definitions of close out terms, reference to appropriate regulations, and links to online resources for information referenced in the guide.

BACKGROUND

Government acquisition professionals are well aware of the emphasis placed on the contract closeout function. The contracting specialist involved with the closeout acts as a problem solver while working with a team of acquisition and other professionals ranging from attorneys to security and property management specialists. A contract is not complete and ready for closeout until the contractor *complies with every term of the contract*. This includes contractual actions related to such areas as Government property, software data rights, patents, security, disposition of subcontracts, and resolving audit findings. A review of contract clauses and an understanding of the Federal Acquisition Regulation (FAR) and guidance and best practices are helpful to effectively audit the agency's close out practices.

Closing a contract is associated with a physically completed contract and involves reviewing the contract and the contract file and the steps taken to close the contract file and dispose of the contract. The actual steps that can be performed in a close out audit can vary significantly. This guide focuses on procedures identified in FAR 4.804-5 for closing out contract files and best practices for administering funds for physically completed contracts. It does not focus on special concerns, such as handling, storing, and disposing of the contract files. Additionally, the audit guide does not focus on special circumstances that can arise for closing contracts that are terminated or that remain open due to legal issues.

Contract closeout is only performed when contracts are physically complete (exception is for terminated contracts). FAR 4.804-4 states that, except for rentals, use, and storage agreements, a contract is considered to be physically complete when: (1) the contractor has completed the required deliveries or performed all the required services and the Government

has inspected and accepted the supplies or services; and (2) all option provisions (for extending or adding to the completed portion) have expired. Physical completion can also occur in the event that the Government gives the contractor a notice of complete contract termination. A contract file shall not be closed if the contract is in litigation/appeal or when a termination is involved but not all termination actions have been completed.

FAR 4.804-1(a) establishes time standards for closing out contract files:

- 1) Files for contracts awarded using *simplified acquisition procedures*¹ should *be considered closed* when the contracting officer receives evidence of receipt of property and final payment, unless otherwise specified by regulation.
- 2) Files for *firm-fixed price* contracts, other than simplified acquisitions, *should be closed within 6 months* after the date on which the contracting officer receives evidence of physical completion.
- 3) Files for contracts requiring settlement of indirect rates (cost reimbursable contracts) should be closed *within 36 months* of the month in which the contracting officer receives evidence of physical completion.
- 4) Files for all other contracts should be closed *within 20 months* of the month in which the contracting officer receives evidence of physical completion.

Administrative procedures required to close a contract are considerable. Given audit time constraints and depending on the size of the audit universe and sample, it is advisable to perform a risk assessment to identify those closeout procedures that should be reviewed. This may include all, a portion, or even just one procedure associated with the closeout process. For example, many audits have been performed recently with a focus on an agency's management of funds as part of the closeout process, along with the agency's history of closing contracts within the FAR specified timelines. Other audits have focused on the agency's practices when closing cost-reimbursable contracts along with the reasonableness of the agency's use of audits or alternative procedures to close these contracts and adjust for potentially unallowable costs. Some audits have also included steps to review the use of Government property. Based on the risk assessment results and/or management decision, audit steps should be tailored to specific audit objectives or cover the specific closeout issue areas selected for the review.

Closeout procedures after acceptance include the contractor's preparation of a final voucher or payment request, typically along with an assignment of refunds, rebates, and credits, and a contract release.

For closing cost reimbursable, time and materials (T&M) and labor hour (LH) contracts annual audits (FAR 42.7) or alternate procedures are required to determine allowable costs and rates before closure.

¹ Currently \$150,000, with some exceptions.

Task orders may be closed individual upon physical completion. Timely closeout of orders before all task orders are completed ensures best use of funds, and may identify unneeded funds that can be better used. Upon final acceptance by the Government, the contractor may prepare a completion voucher for each task order. Orders under time-and -materials and labor hour contracts may also be closed throughout the acceptance process using early close-out procedures. Some orders may be held open until all work is completed or final indirect rates are settled. After completion of all work under all task orders, a separate close out procedure may occur along with a recapitulation of costs for each order.

Problem contract closeouts can occur that require special procedures. For example, a contractor may no longer be in business. If the contracting staff cannot locate the contractor, the contracting officer may consider using a unilateral closeout. In another case, a cost reimbursable contractor may fail to meet the requirement to submit a final voucher. In this instance the contracting officer may make a unilateral determination of the final contract price. The contracting officer may also use an accelerated final voucher and review process in this instance and agree to a simplified final voucher from the contractor. For contractors in bankruptcy, the contracting officer must determine any potential claim against the contractor and coordinate with legal when closing the contract.

DEFINITIONS

"Closeout" of a physically completed contract involves a review of the contract file and taking required actions to close the file. FAR 4.804-5 requires that agencies establish specific procedures that address a number of contract administrative actions before the contract can be closed.

APPLICABLE LAWS AND REGULATIONS

The following laws and regulations prescribe the criteria applicable to acquisition planning not closeout?:

- FAR 4.804-5, "Procedures for closing out contract files" identifies the administrative procedures that must be performed when closing out the contract.

The regulation indicates that contract administration is responsible for the closeout of the contract following physical completion. *At the outset of the process, the contract administration office must review the contract funds status and notify the contracting office of any excess funds that may be deobligated* before completing all required closeout steps and formally closing the contract. (The initial funds review is done at the time of physical completion. At the end of the closeout process, which could be years later in some instances, a final resolution of funds is completed.) When the actions identified in FAR 4.804-5(a) (1) through (15), as applicable, are completed and have been verified, a *contract completion statement* is required. It should state

that all required contract administration actions have been fully and satisfactorily completed. When complete, administrative procedures (as applicable) must ensure that²:

- 1) Initial funds review is completed to identify significant unneeded funds at the time of acceptance;
- 2) Disposition of classified material is completed;
- 3) Final patent or royalty reports are issued;
- 4) There is no outstanding value engineering change proposal;
- 5) Plant clearance report is received;
- 6) Government property is accounted for;
- 7) All interim or disallowed costs are settled;
- 8) Subcontracts are settled by the prime contractor;
- 9) Review of indirect rates and allowable direct costs is completed (generally for cost-reimbursable or time and materials/labor hour contracts);
- 10) Contractor's closing statement is completed (typically includes the release and assignment of rebates and credits);
- 11) Contractor's final invoice has been reviewed (typically cost-reimbursable or time and materials/labor hour contracts); and
- 12) Contract funds review is completed and excess funds deobligated.

Quick closeout procedures identified in FAR 42.708 allow for closing out cost reimbursable contracts early in certain circumstances. Completion of final indirect audits may be a reason that a cost reimbursable contract cannot be closed out immediately. The quick close out process is a valuable tool because it can free up obligated amounts years earlier than waiting for delayed audits, provided justification for quick closeout procedures exists.

Because the agency/department you are auditing may have FAR supplements or other implementing guidance in addition to the criteria identified above, you will also need to identify and become familiar with the requirements and criteria in those documents.

² Your audit may include steps to review all, some, or one of these procedures based on the result of your initial risk assessment, which is typically completed while planning the audit.

AUDIT STEPS

NOTE: When identifying a universe of contracting actions to review for closeout, care should be taken to determine whether a universe/sample should separately address contracts that have exceeded the milestones for being closed. These contract actions generally have obligations/funds that could be deobligated, resulting in potential monetary benefits by recommending steps to eliminate such a backlog. Otherwise all open completed contracts could be reviewed to determine whether unneeded remaining obligations could be drawn down to minimal amounts needed to close out the contract after completion of audits and determination of final contract amounts. Consideration should also be directed toward determining whether a separate universe/sample should be devised to address contracts that were already closed, if the intent is to review the practices used when closing the contracts. Internal agency logs on identifying completed contracts awaiting closeout might also serve as a universe for reviewing contracts awaiting closeout or that have already been closed.

SUBJECTIVE 1: DETERMINE WHETHER THE AGENCY USED EFFECTIVE AND EFFICIENT POLICIES, PROCEDURES, PRACTICES, AND CONTROLS FOR CLOSING OUT CONTRACTS.

- A. Research and analyze the criteria and guidance that the auditee (agency) used for closing contracts. Determine whether it adequately complies with FAR. Compare the practices used to best practices followed by other Federal agencies as identified during audit research. Where is best practice information found? For example: (1) does the agency have a dedicated team for closing contracts; (2) is a log maintained of completed contracts awaiting closeout; (3) does the agency use a Closeout Checklist that confirms delivery and acceptance of goods or services, completion of performance periods, property resolution, resolution of subcontract closeout, final payment audit status, and other administrative issues; and (4) does the agency use performance measures, such as reducing percentages of obligations remaining on physically completed contracts awaiting closeout, or for reducing numbers of contracts by contract type that are open beyond suggested milestone limits?
- B. Identify numbers of physically completed contracts that exceed the time limitations in FAR 4.804-1 for completing contract closeout by type of procurement or contract type. Determine whether reasons for exceeding limitations are justified for a sample of the contracts. Identify amounts not closed without sufficient reasons and causes for exceeding milestones, as necessary.
- C. Analyze the procedures used to closeout completed contracts based on one or more specific areas of FAR.805-5 selected for review as part of the initial planning/risk assessment process.
 - 1. Review each issue area against applicable FAR criteria and clauses and determine whether adequate support exists in the contract file to

demonstrate that the issue areas reviewed was addressed properly during the closeout process.

2. Determine whether the contract completion statement documents that all contract clauses were complied with.
 3. Review to determine compliance with FAR for the following special issue areas, if selected for review: patents and inventions (FAR 27.102 and 27.302(c); royalty payments (FAR 27.202-3 and 52.227-9); and value engineering changes (FAR 48.1.1).
- D. If selected for review, determine whether applicable audits were obtained of annual allowable direct hours or costs and unallowable rates (as applicable) for all cost-reimbursable, time and materials, and labor hour contracts (FAR 42.7). Ensure that the contracting office determined that all rates and unallowable costs were resolved before closing the contract. If audits were not obtained, determine whether reasonable justification was obtained and documented in the contract file. Also, determine whether quick closeout procedures (FAR 42.708) were documented or whether alternate procedures were reasonable and ensured that the Government did not overpay for the cost reimbursable work performed. (Note, a review of procedures to determine final allowable costs for cost-reimbursable, T&M, and LH contracts could also be performed as a separate audit.)
- E. Analyze the closeout process for duplication of effort or other opportunities to reduce resource investment without sacrificing quality.

SUBOBJECTIVE 2: DETERMINE WHETHER THE AGENCY REVIEWED FUNDS REMAINING ON PHYSICALLY COMPLETED CONTRACTS EFFECTIVELY AND EFFICIENTLY TO DETERMINE WHETHER THEY CAN BE USED ON OTHER PROJECTS.

- A. Allowing contracts to remain open beyond the limitations in FAR 4-804.1 results in obligations remaining idle, although they may be needed for obligating other projects; pay expenditures on other contracts; or for use in deficit reduction. Review amounts unreasonably open due to weaknesses in closeout procedures or lack of attention directed to closeout. Make recommendations to shorten the closeout process so funds can be put to better use.
- B. Review the agency's methods for performing the initial funds review that FAR 4.804-5(a) requires at the time physical completion occurs for a sample of contracts. Select a sample of transactions and review for effectiveness and efficiency. Identify amounts that could have been drawn down, while leaving a reasonable reserve for settling unaudited indirect rates and making final payment.

**Attachment: Clauses That May Require Attention
When Closing Contracts (Not All Inclusive)**

<u>Clause/FAR Topic</u>	<u>FAR Reference</u>
Closeout Memorandum	4.804-5
Liquidated Damages	52.211-11
Economic Price Adjustment	52.216-2
Incentive Fee	52.216.10 ³
Limitation of Cost	52.232-20 ⁴
Government Property	52.245-1

³ After a performance period ends for an award fee contract any unused portion of the award pool may be de-obligated.

⁴ This requires that the contractor notify the Government of significant excess funding, which can be immediately deobligated.

**Audit Checklist (Suggested and Not All Inclusive)
Depends Upon the FAR Closeout Procedures Included in the Audit**

Acceptance.

- Items were received, inspected, and accepted.
- DD 250 Receiving Report on File

Initial Funds Review

- Evidence is documented that there was a funds review at or shortly following Government acceptance. Explanation exists if significant funds were not deobligated. Funds review was coordinated among responsible parties, such as financial accounting or budget and the contracting office.

Dates

- FAR time limits for closing contracts by type of contract are being complied with.

Property

- All Government-furnished property is accounted for.

Payments

- Disallowed costs were resolved.
- Final audit closing statement obtained, if applicable.
- Final indirect rates and allowable costs for cost reimbursable contracts were determined.
- Final funds review. Excess funds were deobligated before closing the contract.
- Required royalty and patent reports were received, if applicable.

Subcontracts

- Final subcontract amounts were established.

Contract Completion Statement

- A memorandum is in the file that verifies contract closes were complied with.

Cost Reimbursable Contracts

- DCAA audits were obtained or the file documents reasonable procedures in the event that audits were not obtained.
- Quick closeout procedures, if used, followed applicable regulations.