

**Testimony of  
Thomas P. Skelly  
Director, Budget Service  
U.S. Department of Education**

**Before the Subcommittee on Contracting Oversight  
U.S. Senate Committee on Homeland Security and Governmental Affairs**

**Hearing on  
“Improving Federal Contract Auditing”**

**February 1, 2011**

Good afternoon, Chairman McCaskill, Ranking Member Brown, and distinguished Members of the Subcommittee. Thank you for the opportunity to appear before you today to discuss Federal contract auditing, and thank you for your leadership on this important issue.

My name is Tom Skelly, and I am the Director of the Budget Service for the U.S. Department of Education. Since 2008, I have also been delegated the authority to perform the functions and duties of the Chief Financial Officer (CFO). In this role, I lead the organization that provides accurate and timely accounting and financial management information, coordinates internal controls and audit follow-up, and manages contracts and acquisitions. I am proud to report that the Department’s financial statements have earned nine straight clean opinions and recognition for excellence in financial reporting from the Association of Government Accountants.

In the past, we have not had many opportunities to benefit from contract audits. In our April 2010, response to you, we identified only one external audit, and we expect only one this year. The primary reason for not having many contract audits is that most of our contracts are fixed-price, and government cost risk on that type of contract is relatively low. The Department also has many competing priorities for administrative funding. Therefore, even with cost-reimbursement contracts, we limit the use of contract audits to those situations that need a review of incurred costs, and to assist in closing out contracts.

Although the Department has one of the largest discretionary budgets, the Department also has the smallest workforce of any cabinet-level agency. Less than one percent of our annual funding is spent on administrative activities.

In fiscal year 2010, the Department had approximately 4,200 employees. This number represents a decrease of about 10 percent over the past decade, even as the workload has grown. For example, the enactment of the Ensuring Continued Access to Student Loans Act of 2008 and the Student Aid and Fiscal Responsibility Act of 2010 greatly expanded our student loan work. These loan programs and related increases in Pell Grant applications have been the main drivers of our increased work, but the Department also had a key role in the Recovery Act, through which innovative and competitive K-12 education reform efforts were expanded through such grants as Race to the Top and Investing in Innovation.

We have used contracts to perform much of the increased work involving student aid, and the dollar volume of contracts has increased. We spent approximately \$1.5 billion on contracts in fiscal year 2009 and \$1.8 billion in fiscal year 2010. Most of the increase was for student-aid processing and loan-servicing contracts. These contracts tend to require performance of high volumes of routine and similar tasks, like application processing, loan origination, and loan servicing and collection. We have contracted for these kinds of activities for three decades, and the work volume has grown dramatically in recent years.

In fiscal year 2010, only 21 percent of the contract dollars and 9 percent of the contract actions awarded by the Department were cost-reimbursement, and we are further reducing our reliance on cost-reimbursement contracts each fiscal year. Eight of the Department's top ten contracts (representing 96 percent of the spending on our largest contracts) are fixed-price. Examples of cost-reimbursement awards include contracts to analyze student achievement data from the National Assessment of Educational Progress (NAEP) and an ongoing contract with Reading Is Fundamental, Inc., to distribute inexpensive books to children and undertake other activities that promote reading and literacy.

The Department's Office of Inspector General (OIG) conducts independent audits, investigations, inspections, and other reviews of programs and operations. Part of this responsibility includes contract audits. In determining what to review, OIG considers internal risk assessments, Department requests, Congressional requests, and hotline information or other sources that contain allegations of concern.

As noted in last April's response to you about contract audits, in fiscal year 2009, OIG completed an incurred cost audit of a contract that the Department had entered into for the administration of part of the National Assessment of Educational Progress (NAEP). The purpose of the audit was to determine whether the costs incurred in fiscal year 2006 under the contract were reasonable, allowable, and allocable in accordance with the terms and conditions of the contract and applicable acquisition regulations. The approximate cost to the Department to perform this audit was \$255,123.

As a result of this audit, OIG recommended that: (1) the Department recoup unallowable costs paid to the contractor; and (2) then conduct a follow-up review of the costs not included in OIG's sample. The Department recouped \$229,723 from the contractor for the FY 2006 costs identified by OIG. In addition, the contractor disclosed during the audit that it had inappropriately billed the Department for post-retirement medical benefits during the period September 2002 through December 2007. The contractor returned to the Department \$2.7 million in April 2009 for these improper billings.

We considered several options for a follow-up audit. The OIG decided not to devote limited resources to a broader audit. The Department initiated a request to the Defense Contract Audit Agency (DCAA) for audit support to review the incurred costs not included in OIG's sample. To obtain this support, Department representatives worked with DCAA in 2010 to determine the scheduling and the cost for a follow-up audit, which was estimated to cost \$27,000. In September 2010, DCAA confirmed that the requested audit was not programmed in DCAA's schedule for fiscal year 2011. As a result, the Department contracted for audit support services. That contract includes performing the incurred cost audit, which will be conducted this year.

The Department faces challenges regarding contract audits in deciding whether they take priority over other demands for limited funds. The Department's OIG has multiple priorities, and DCAA cannot always accommodate non-DoD requests for audit support. Obtaining audit support from a non-governmental firm can be costly and time-consuming.

In conclusion, we support efforts to maximize the performance of contractors in delivering Department services. We rely on many contractors to get the work done. We believe that fixed-price contracts are the preferred option over cost-reimbursement contracts as they provide a better value to the tax payer.

Thank you, Madam Chairman and Members of the Subcommittee, for your attention to this important issue, and I would be happy to answer any questions.