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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION



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The Honorable Elliot L. Richardson
The Secretary of Defense 5

Attention: Assistant Secretary of Defense
(Comptroller)

Dear Mr. Secretary:

We reviewed the contracting officials' practices in settling Defense Contract Audit Agency (DCAA) reports recommending reductions in contract prices that DCAA believed had been increased because contractors had submitted cost or pricing data that was not accurate, complete, or current (defective data). The requirements for contractors to submit cost or pricing data and certificates and the Government's rights to price reductions are covered in the Truth-In-Negotiations Act. 473

We wanted to find out (1) whether DCAA reports were providing contracting officials with the information needed to reduce contract prices when such prices had been increased because defective data had been submitted, (2) why the officials had determined that they did not have a basis to reduce contract prices in the amounts proposed by DCAA, and (3) whether purchasing offices were taking prompt actions in settling DCAA reports.

We are making a number of recommendations which, we believe, will (1) reduce the number of DCAA reports that do not provide contracting officials with an acceptable basis for price reductions, (2) increase acceptance of DCAA's recommendations for price reductions, and (3) reduce the time required to settle the reports.

BACKGROUND

Public Law 87-653, the Truth-In-Negotiations Act, effective December 1, 1962, requires that each contract, whose price is negotiated on the basis of cost or pricing data submitted

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by the contractor and certified to be accurate, complete, and current, contain a defective pricing clause. This clause gives the contracting officer an enforceable right to reduce the negotiated price by any significant amounts by which the price was increased because the contractor submitted defective data.

Contract prices negotiated on the basis of cost or pricing data have averaged about \$14 billion for each fiscal year since 1963.

In March 1966 DCAA established a program to perform post-award audits of contractors' submissions of cost or pricing data. When DCAA determines that the contract price was increased because a contractor submitted defective data, the facts are reported to the contracting official who negotiated the contract with a recommendation for a price reduction. The contracting officer determines whether the Government has a legal right to a price reduction under the terms of the contract.

In making this determination, the contracting officer usually obtains contractor's comments and DCAA's response to these comments and considers whether the reduction recommended by DCAA was based on the contractor's failure to submit accurate, current, and complete data. When the contractor has failed to do so, the contracting officer further considers whether:

- The defective data was relied on in negotiating the price.
- The contractor certified to the accuracy, currentness, and completeness of the defective data.
- The defective data had a significant effect on the price negotiations.

From the beginning of the program in 1966 to June 30, 1972, DCAA selected 7,855 contracts totaling \$69.9 billion for postaward audit. DCAA reported that defective data had been submitted for 1,317 contracts and proposed price reductions of \$336 million.

As of June 30, 1972, contracting officials reported to DCAA that they had determined the Government's right to a price reduction on 424, or 32 percent, of these contracts. For these contracts, DCAA reported that contractors had submitted defective data that increased the prices to the Government by

\$119 million. Contracting officials concluded that the Government had a right to reduce contract prices by \$38 million, or 32 percent of the amount recommended by DCAA, and that for various reasons the Government did not have a right to recover the remainder of \$81 million, or 68 percent of DCAA's recommended reductions.

We reviewed 177 of the 424 contracts on which contracting officials had completed their determinations. DCAA had recommended reductions of \$46 million, but contracting officials had concluded that there was defective pricing of only \$21 million and had taken action to obtain recoveries. Of the remaining \$25 million, contracting officials:

- For \$19 million, disagreed with DCAA that contractors had submitted defective data.
- For \$6 million, agreed with DCAA that the contractor had submitted defective data at the date of price agreement but concluded that the Government did not have a right to reduce contract prices.

WHY CONTRACTING OFFICERS DID NOT ACCEPT
DCAA'S RECOMMENDATIONS FOR PRICE REDUCTIONS

Defective data had not been submitted

The most frequent reasons contracting officers did not accept DCAA recommendations were that DCAA findings were based on

- data which became available after the date of price agreement,
- data which was incomplete or incorrect, or
- data which Government officials said had been disclosed during negotiations or they could not refute the contractor's contention that the data had been disclosed to them.

Examples follow.

1. In April and May 1967 a purchasing office negotiated two firm fixed-price modifications to an existing contract for fuze assemblies. The contractor's price proposal for additional units included estimated unit

labor cost based on a prior 15-month period of labor-cost experience. DCAA made a postaward audit for defective pricing and concluded that the 15-month period used by the contractor did not include the most current 3-month period immediately before the negotiations.

DCAA used the cost experience furnished by the contractor for the 12-month period ended just before the date of negotiations. On this basis DCAA recommended a reduction of \$265,000, because the estimated labor cost was higher than indicated by the more current labor-cost experience.

The contractor said that DCAA had been given incorrect data for the 12-month period. The contractor submitted a revised computation for the same period and claimed underestimated labor costs of \$18,000. DCAA verified the revised computation and withdrew its recommendation.

2. In July 1967 DCAA made a postaward audit for defective pricing and reported that the contractor's material cost estimate of \$1 million was \$285,000 higher than indicated by six purchase orders issued after the date of the certificate. Apparently the auditor had considered all data available up to the date the Government signed the contract as pertinent to the price negotiation.

In August 1968 the contracting officer decided not to accept DCAA's recommendation for price reduction, because the purchase orders were issued after the date of the contractor's certification.

3. In negotiating a contract to manufacture missiles, the contractor had proposed developmental labor costs of \$9 million on the basis that development labor-hours would be 23 percent of the engineering labor-hours as experienced under previous contracts. During negotiations the percentage was reduced to 19 percent.

In September 1969 DCAA made a postaward audit for defective pricing and found that, at the time of the negotiations, the contractor had completed about one-half of the engineering effort and had incurred developmental labor-hours which amounted to only about 10 percent of engineering labor-hours. DCAA reported that the contractor had not furnished this information

during negotiations and recommended a price reduction of \$7 million which included add-ons for indirect costs plus fee.

In December 1970 the contracting officer decided not to accept DCAA's recommendation because, in his opinion, the contractor had furnished this data to the Government during negotiations.

We found no evidence of this disclosure. In fact, the price negotiation memorandum indicated that the 19-percent factor was used on the basis of actual data from previous contracts.

4. In July 1967 a purchasing office negotiated a contract for spare parts amounting to \$1 million which included an estimated production cost of \$354,000 for one part. The contractor had been authorized to start in September 1966.

In April 1969 DCAA made a postaward audit for defective pricing and reported that the estimated production costs were \$27,000 higher than indicated by actual production costs available to the contractor at the time of negotiations. The contractor contended that the data had been disclosed. In June 1971 the contracting officer decided not to accept DCAA's recommendation. He said that he could not disprove the contractor's contention and that the Government negotiator could not recall with certainty what data had been disclosed.

Defective data had been submitted

The most frequent reasons for contracting officers' determining that the Government did not have a legal right to price reductions, when contracting officers agreed with DCAA's findings that defective data had been submitted by contractors, were

- the defective data had not been certified by the contractor as accurate, complete, and current as of the dates of negotiations or
- the defective data had no significant effect on the prices negotiated.

Examples follow.

1. In May 1966 a contractor submitted a price proposal for certain fuzes supported by cost or pricing data and a certificate. In June 1966 the purchasing office issued a letter contract, and the contractor submitted a proposal to definitize the letter contract. Price negotiations were concluded in September 1966, and a contract was signed in October 1966. An updated certificate was not obtained from the contractor.

DCAA made a postaward audit for defective pricing in December 1967 and reported that the contractor had not submitted to the Government suppliers' price quotations available during August 1966 before the negotiations. Because the material cost estimates were higher than indicated by the suppliers' quotations, DCAA recommended a price reduction of \$815,000.

The contracting officer decided in April 1970 not to accept the DCAA recommendation because, although the data submitted by the contractor in support of the revised proposal was defective and was relied on in price negotiation, the contractor had not submitted a certificate. Therefore, the contracting officer reasoned, there was no legal basis for a price reduction under the contract clause.

2. In another case, DCAA recommended a \$102,000 reduction because the contractor had not submitted his latest labor-cost data. About \$57,000 was not sustained by the contracting officer because he adjusted the DCAA recommendation downward to give effect to a lump-sum reduction of the contractor's total proposed price during the negotiations. In doing so, the contracting officer reasoned that, although the price negotiation memorandum did not identify the reduction by cost element, it could be assumed that part of it was a reduction in labor cost. Therefore the defective labor-cost data submitted by the contractor had no effect on the price negotiated.

DEFICIENT PRACTICES THAT CONTRIBUTED TO
REJECTION OF DCAA'S RECOMMENDATIONS

We identified several contracting officials' practices in negotiating contract prices and in evaluating DCAA's

findings which contributed to the high rate of rejections of DCAA's recommendations for price reduction.

- Contracting officials had not required contractors to submit cost or pricing data that (1) identified the data, (2) stated what the data represented, and (3) described how the data was used in arriving at the proposed price. When the contracting officer failed to obtain data meeting these criteria and DCAA reported that estimated costs were higher than indicated by data available to the contractor at the time of negotiation, the contracting officer could not determine with certainty that the available data had, in fact, not been disclosed to the Government.
- Contracting officials determined that the defective data reported by DCAA had had no effect on the negotiated price, although there was no evidence that such data had not been relied on or used in price negotiations. These determinations were not in accord with Department of Defense regulations which provide that, in the absence of evidence to the contrary, the natural and probable consequence of defective data is an increase in price. Further, the price negotiation memorandums did not show, although required by regulations, the extent to which data submitted had not been relied on or used in negotiations.
- Contracting officers' determinations not to accept DCAA recommendations generally were not reviewed and approved by higher authority.
- Contracting officials had obtained contractor certificates which (1) were not executed as of dates as close to the negotiation dates as practicable, although required by law, or (2) did not conform to prescribed regulations. As a result, contracting officials disagreed with DCAA findings of defective data when such data became available after the effective date of the certificate or when such data was not covered by a properly prepared certificate. Nevertheless DCAA continued to report such cases as defective pricing on the basis that, since a properly executed certificate is required by law or regulations, it may be assumed to have been furnished by the contractor.

A recent decision of the Armed Services Board of Contract Appeals (No. 15084, Dec. 21, 1972) holds that, in the absence

of a certificate, the contractor is not liable under the defective pricing clause in its contract. DCAA is considering the effect of this decision on its reporting of defective pricing when properly executed certificates have not been obtained.

DELAYS IN SETTLING DCAA'S RECOMMENDATIONS

Of the 177 settled cases we reviewed, 45 percent of the contracting officials' determinations were made more than 6 months after they received the DCAA report. Some were settled several years later. Settlements were delayed primarily because purchasing officials were involved in other work which they believed had a higher priority than price reductions for defective data. As of June 30, 1972, DCAA reports on 893 contracts, or 68 percent of those reported, had not been settled. These reports contained recommendations for reductions of \$217 million.

RECOMMENDATIONS

We recommend that, for purchasing officials to effectively and efficiently settle DCAA's recommendations for price adjustment, the Secretary of Defense take the following actions:

- Insure that contracting officials comply with requirements for negotiating contract prices (1) by obtaining from contractors an adequate submission of cost or pricing data and (2) by explaining in the price negotiation memorandums the extent of their nonreliance on the data submitted.¹
- Require that determinations which do not accept DCAA recommendations on the basis that the pertinent data was disclosed, or the Government officials were aware of the data, should be reviewed and approved by higher authority than the contracting officer.

¹Defense Procurement Circular 100, May 26, 1972, instructs contracting officials on the need to clearly state in the memorandum of price negotiations the extent submitted data was not relied upon.

- Emphasize to contracting officials the requirement that, in the absence of other evidence to the contrary, contract prices should be reduced by the amount of the defective data.
- Clarify Department of Defense policy for the disposition of defective pricing cases that involve certificates which do not conform to the prescribed regulations or which are not submitted as close to the date of negotiations as practicable.
- Establish time standards for purchasing offices to accomplish each major step in the settlement of reports on defective pricing not to exceed a reasonable time, such as 6 months from the date of the DCAA report.

We also recommend that the Director, DCAA, have his top regional officials closely review proposed reports of defective pricing before issuance to insure that contracting officials are provided an acceptable basis to reduce contract prices.

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We shall appreciate receiving your comments on these matters. Please let us know if you need additional information.

We are sending copies of this letter to the Director, Office of Management and Budget; the Director, DCAA; and the Secretaries of the Army, Navy, and Air Force.

Sincerely yours,


for Director