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Office of Inspector General

Date: SEP 28 2007

To: Mr. David A. Elizalde, Director
Division of Acquisition and Cooperative Support

From: *Deborah H. Cureton*
Deborah H. Cureton
Associate Inspector General for Audit

Subject: NSF OIG Audit Report No. 07-02-008, Review of Reasonableness of VECO USA, Inc's Proposed Increased Fee Associated with an Accounting Change

This letter report discusses the results of our review of an increased fee/profit proposed by VECO USA, Inc. (VECO) in conjunction with a change in the company's accounting for indirect costs.

Background

On May 18, 2006, VECO submitted a revised Disclosure Statement to NSF that included a proposed accounting change to its general and administrative (G&A) base which impacted NSF's cost-plus-fixed-fee Contract No. OPP-0001041. VECO also submitted a cost impact proposal to NSF that proposed a total increase of [REDACTED] to the NSF contract as a result of the accounting change. This amount was comprised of \$[REDACTED] in increased G&A costs as well as [REDACTED] in increased fee recovery. The results of Defense Contract Audit Agency's (DCAA) audit of VECO's proposed accounting change and associated cost impact are discussed in a separate audit (Audit Report No. OIG-07-1-016). However, DCAA did not express an opinion on VECO's proposed increased profit amount because fee/profit determinations are made by the Contracting Officer.

The purpose of our review was to determine the reasonableness and allowability under Federal Acquisition Regulations (FAR) of reimbursing VECO the proposed increased fee that resulted from VECO's accounting change to its G&A base. We conducted our review in accordance with generally accepted government auditing standards. To accomplish our objective, we obtained and reviewed contractual documents, interviewed the NSF Contracting Officer, and researched applicable FAR, obtaining expert advice as necessary.

Results of Review

We determined that it is not reasonable to reimburse VECO the proposed [REDACTED] of increased fee/profit that resulted from VECO's accounting change because it does not comply with the FAR.

NSF Contract No. OPP-0001041 is a cost-plus-fixed-fee contract which is "a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fixed fee does not vary with actual cost, but may be adjusted as a result of changes in the work to be performed under the contract."¹ FAR 16.102(c) prohibits the cost-plus-a-percentage-of-cost system of contracting by stating: "The cost-plus-a-percentage-of-cost system of contracting shall not be used (see 10 U.S.C. 2306(a) and 41 U.S.C. 254(b))." In general, any contractual provision is prohibited that assures the contractor of greater profit if it incurs greater costs. The fixed fee may be adjusted if the government directs the contractor to perform additional work not covered within the scope of the original contract, but this exception is not applicable to the subject VECO accounting change.

VECO's cost impact proposal totaling [REDACTED] is comprised of [REDACTED] in increased G&A costs as well as [REDACTED] in increased fee recovery. The increased fee was calculated at [REDACTED] of the proposed increased G&A costs of [REDACTED] or [REDACTED], that resulted from the accounting change. NSF accepted both VECO's proposed increased costs for the accounting change and proposed increased fee by means of Contract Modification No. 23, dated March 21, 2007, and established a settlement for G&A costs and fee recovery in the amount of [REDACTED]. NSF provided partial funding of the settlement amounting to [REDACTED] and stated that, "the remaining funding of [REDACTED] is scheduled to be provided in FY 2008." As a result, NSF's settlement amount of [REDACTED] in Contract Modification No. 23 (based on VECO's cost impact proposal wherein VECO applied a [REDACTED] rate to its proposed actual performance costs) violates the proscription against the cost-plus-a-percentage-of-cost system of contracting.

We discussed our finding and recommendation with the current NSF Contracting Officer who agreed with our conclusion and stated that she intends to disallow the increased profit amount of [REDACTED].

Recommendation

We recommend that NSF negotiate with VECO to reverse the increased fee/profit of [REDACTED] which was based on a percentage of VECO's proposed actual performance costs to avoid violating the proscription against the cost-plus-a-percentage-of-cost system of contracting.

To help ensure the finding is resolved within six months of issuance of the audit report, please coordinate with our office during the audit resolution period to develop a mutually agreeable resolution of the audit recommendation. NSF Contract No. OPP-0001041

¹ Reference FAR 16.306(a).

should not be closed until NSF determines that this recommendation has been adequately addressed and the proposed corrective action has been satisfactorily implemented.

We are providing a copy of this memorandum to the Director of the Office of Polar Programs. The responsibility for audit resolution rests with DACS. Accordingly, we ask that no action be taken concerning the report's finding without first consulting DACS at (703) 292-8242.

We thank you and your staff for the assistance extended to us during the audit. If you have any questions about this report, please contact Jannifer Jenkins at (703) 292-4996 or David Willems at (703) 292-4979.

cc: Karl Erb, Director, OPP
Mary Santonastasso, Director, DIAS