



Highlights of [GAO-08-269](#), a report to congressional committees

Why GAO Did This Study

One-third of the Department of Defense's (DOD) fiscal year 2006 spending on goods and services was for subcontracts. Concerns have been raised among DOD auditors and Congress about the potential for excessive pass-through charges by contractors that add little or no value when work is subcontracted. To better understand this risk, Congress mandated that GAO assess the extent to which DOD may be vulnerable to these charges. This report examines (1) DOD's approach to assessing the risk of excessive pass-through charges when work is subcontracted, (2) the strategies selected private sector companies use to minimize risks of excessive pass-through charges when purchasing goods and services, and (3) DOD's interim rule to prevent excessive pass-through charges.

GAO's work is based on analysis of 32 fiscal year 2005 DOD contract actions at 10 DOD top contracting locations and discussions with DOD acquisition policy, audit, and contracting officials, including Defense Contract Audit Agency (DCAA) and Defense Contract Management Agency (DCMA) staff. GAO also interviewed nine selected private sector companies with diverse contracting experience.

What GAO Recommends

GAO is recommending that DOD guidance to implement its interim rule requires that assessments of pass-through charges be risk-based and involve DCAA and DCMA as appropriate. DOD concurred with the recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-269](#). For more information, contact Ann Calvaresi Barr at (202) 512-4841 or calvaresibarra@gao.gov.

DEFENSE CONTRACTING

Contract Risk a Key Factor in Assessing Excessive Pass-Through Charges

What GAO Found

Although no specific criteria exist for evaluating contractor value added, DOD contracting officials generally rely on tools in the Federal Acquisition Regulation (FAR) to assess the risk of excessive pass-through charges when work is subcontracted. For the 32 selected contract actions GAO reviewed, DOD contracting officials generally applied these tools to their assessments. The degree of assessment depended on whether the contract was competed and whether the contract type required the government to pay a fixed price or costs incurred by the contractor. When using full and open competition, contracting officials assessed contractor value added based on the technical ability to perform the contract, but did not separately evaluate cost since market forces generally control contract costs, potentially minimizing the risk of excessive pass-through charges. However, when using noncompetitive contracts, contracting officials were required to evaluate more detailed cost information in assessing value added, as market forces did not determine the contract cost. For example, for a \$3 billion noncompetitive contract for an Air Force satellite program, contracting officials assessed detailed cost or pricing data that included subcontractor costs, and received DCAA and DCMA support to negotiate lower overall contract costs. However, assessing contractor value added is especially challenging in unique situations where requirements are urgent in nature and routine contracting practices may be overlooked. Related GAO work and DOD audits on contracts awarded for Hurricane Katrina recovery efforts found multiple layers of subcontractors, questionable contractor value added, increased costs, and lax oversight.

The selected private sector companies GAO interviewed rely heavily on acquisition planning, knowledge of supply chain, and managing contractual relationships to minimize risk of excessive pass-through charges when purchasing goods and services. They seek to optimize competition to minimize overall contract costs, and several companies indicated that they prefer fixed-price competitive arrangements. In addition, some form collaborative business relationships with contractors and subcontractors that provide greater insight into their supply chains and costs—a challenge DOD continues to face. When using other than fixed-price contracts, they recognize the financial risks and ensure proper oversight and accountability. As GAO has reported in the past, DOD's use of riskier contracts, such as time-and-materials contracts, has not always ensured good acquisition outcomes.

DOD recently issued an interim rule requiring a contract clause in all eligible contracts, which allows it to recoup contractor payments that contracting officers determine to be excessive. The rule also requires detailed information from contractors on their value added when subcontracting costs reach 70 percent or more of total contract cost. However, the rule alone will not provide greater insight into DOD's supply chain and costs—information companies told us they use to mitigate excessive costs. Further, contracting officials indicated the need for guidance to ensure effective implementation and consistent application of tools in the FAR as appropriate.