



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

095990
~~4-14-84~~

~~74-0415~~

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

DEC 11 1973

B-156806

No 4



The Honorable
The Secretary of Defense ✓

Attention: Assistant Secretary of Defense
(Comptroller)

Dear Mr. Secretary:

On December 11, 1972, we forwarded for your comments our findings and proposals on the military services' use of escalation clauses. (See OSD Case No. 3556.)

We emphasized the need for guidance at the Department ✓
of Defense level for determining when escalation clauses
should be used and for establishing the provisions of escalation clauses. Our examination showed that the military services were inconsistent in providing for escalation payments. Using different methods could result in differences in payments for economic fluctuations.

02168

The Acting Assistant Secretary (Installations and Logistics) advised us on February 14, 1973, that your department has known of these matters for some time. He said the Armed Services Procurement Regulation Committee was considering the advisability of revisions that would substantially agree with our proposal.

On March 28, 1973, a revision to the Armed Services Procurement Regulation was approved. The revision provides criteria for determining when to use escalation clauses and guidelines for establishing the provisions of the clauses. The guidelines for special economic price adjustment clauses are similar to those which the Navy uses for ship construction contracts.

Under these guidelines the provisions for escalation payments will be established before soliciting bids or offers from several offerors. They will provide the percentages of

~~701803~~ / 095990

the contractor's price that will be designated as material and labor costs to be spent during the periods to which changes in specified indexes will be applied. The guidelines state that the contracting officer shall determine the percentages of the contract price for labor and material and rates of expenditures, in a manner which will, as nearly as possible, approximate the average expenditure profile of all companies to be solicited. Because such advance provisions based on averages can be unrealistic to the offerors' plans for contract performance, each offeror can be expected to increase or decrease his offered price for the provisions which do not conform to his contract performance plans. The actions can result in estimates for inflation being a substantial factor in proposed prices.

In a letter dated April 11, 1973, the Acting Assistant Secretary commented on a method we had proposed which would minimize the need for contractors to include contingencies for economic fluctuations in prices for competitive awards.

Under our proposed method, potential offerors would be advised of the price indexes and the anticipated changes during contract performance to be used for estimating payments for economic fluctuations. Each offeror would be requested to submit a proposed price on the basis of current costs and a separate escalation payment estimate on the basis of the anticipated changes applied to his own estimated expenditures of labor and material over the life of the contract. The contracting officer would consider both the price proposed on current costs and the estimate in determining the lowest overall price to the Government and in establishing the contract price. The cost factors for the estimate would be included in the contract escalation clause and would not be subject to change. The clause would provide for adjusting the estimate included in the contract price if actual changes in the indexes are different from those provided for estimating payments.

The Acting Assistant Secretary said that your department could find no distinct advantage in adopting our proposal and that its adoption could result in unsuccessful offerors' protests and the Government being placed in the position of having to defend its projections of anticipated changes in price indexes. Because of this possibility, we are not recommending that the method we proposed be adopted at this time but plan to evaluate the effectiveness of the revised procedures.

B-156806

We believe, however, that further improvements are necessary if the need for contractors to include contingencies for economic fluctuations in their proposed prices is to be minimized.

We are sending a copy of this letter to the Director, Office of Management and Budget.

Sincerely yours,

A handwritten signature in black ink, appearing to read "R. W. Gutmann". The signature is written in a cursive style with a horizontal line underlining the name.

R. W. Gutmann
Director