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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-205285

FEBRUARY 23, 1984

The Honorable Jack Brooks
Chairman, Subcommittee on Legislation
and National Security
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

Subject: Escalation in Engineering Labor Rates
at Defense Contractors (GAO/NSIAD-84-21)

In response to your September 17, 1982, request and subsequent discussions with your office, we have reviewed a report issued in March 1982, by the Defense Contract Audit Agency (DCAA) at the Pratt and Whitney Aircraft Company, West Palm Beach, Florida. The report dealt with increases in Pratt and Whitney's labor rates for engineers and other employees in 1981 and with increases proposed for 1982, 1983, and 1984 for a forward pricing labor rate agreement between Pratt and Whitney and the Department of Defense (DOD). (Forward pricing labor rate agreements are voluntary agreements between contractors and the government which estimate future labor rates to facilitate pricing anticipated contracts during specified future periods.)

As agreed with your office, our primary objectives were to review (1) the 18.8 percent increase DCAA reported in the average engineering labor rates at Pratt and Whitney in 1981, and (2) the validity of DCAA's reported \$155 million in excess costs estimated to be incurred by the government during the period 1981-84.

The details of the results of our review are included in enclosure I and are summarized below.

DCAA reported that a substantial increase in Pratt and Whitney's average engineering labor rates in 1981 and proposed increases for 1982-84 would result in excess cost to the government of over \$155 million. DCAA considered these increases to be excessive because they were substantially higher than its estimates of the increases experienced and to be experienced by government and private sector workers. DCAA

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recommended to the Air Force administrative contracting officer that he negotiate downward adjustments in the Pratt and Whitney proposed labor rates to bring them more in line with government and private sector pay increases and to offset excess costs alleged by DCAA to have been incurred in 1981.

The 18.8 percent labor rate increase reported by DCAA was the difference between 1980 and 1981 composite average labor rates for the three classifications of engineering employees at Pratt and Whitney. It was overstated because it was not adjusted to eliminate the effects of changes in the proportion of hours worked by higher paid engineers compared to lower paid technicians. Increases in labor rates for the three separate categories were 15.2 percent for technicians, 15.0 percent for engineers, and 14.1 percent for managers. Although these increases were high, even after adjustment for the change in hours, we found that they were not representative of the trend at Pratt and Whitney for previous years. Its annual labor rate increases for engineers for the prior 3 years ranged from 5.8 to 8.0 percent.

While we found that the \$155 million estimate of excessive cost was mathematically correct, we believe that DCAA's estimate is questionable. In its computation DCAA departed from established practices and made assumptions which did not reflect adequate consideration of the underlying uncertainties.

The \$155 million estimate was based on a comparison of Pratt and Whitney experienced and proposed increases with an average of similar increases for private industry and the Federal government. The use of Federal increases, which resulted in lowering the average increase used in the comparison, was a departure from Defense Acquisition Regulation (DAR) guidance. If this guidance had been followed, the estimate would have been reduced by about \$30 million. Moreover, the estimate was based on an assumption that the government would accept the labor rates proposed by Pratt and Whitney without modification, even though the contracting officer had earlier recommended the use of Pratt and Whitney's proposed rate for 1982, but lower rates than those proposed for 1983 and 1984. Finally, while relatively large increases in labor rates can lead to unreasonably high labor costs, a conclusive determination and comparison can only be made by examining the total compensation package from year to year. The DCAA report focused on increases in labor rates rather than total compensation. Use of total compensation data could materially increase or reduce DCAA's estimate of excessive cost.

Because DCAA believed that Pratt and Whitney's labor increases were excessive in 1981, it recommended that 1982 and

1983 increases for the forward pricing rate agreement be limited to offset the excessive costs. In our view, DCAA's recommendations were not appropriate given (1) the purpose and nature of forward pricing agreements, and (2) the questions that can be raised about DCAA's estimate of excessive costs.

You also asked us to determine whether (1) increases in average labor rates at Pratt and Whitney and at four other contractors were excessive in relation to the increases for government and private sector employees, as reported by the Bureau of Labor Statistics (BLS) in its nationwide survey, and (2) the administrative contracting officers at selected contractors utilized DCAA's findings and recommendations in negotiating forward pricing labor rate agreements.

In reviewing the average increases in labor rates for engineers at the five contractors we visited, including Pratt and Whitney, we found that the 4-year (1977-81) averages for such increases were in line with increases in the private sector. Pratt and Whitney increases for 1981 were substantially higher than three of the four contractors and the private sector. Increases at the five contractors and in the private sector were generally higher than increases in government rates.

We also found that contracting officers at three of the other four contractors we visited utilized DCAA's assistance and recommendations during labor rate negotiations. The fourth contractor has not had a forward pricing agreement for labor rates for several years; and in light of the problems relating to the DCAA report, the administrative contracting officer at Pratt and Whitney did not attempt to negotiate the rates proposed by DCAA in the March 1982 report. A forward pricing agreement has not been negotiated with Pratt and Whitney since 1980.

The objectives, scope, and methodology of our review are described in enclosure II. We did not obtain official agency or contractor comments on this report, but we briefed DCAA officials on our findings relating to its March 1982 report.

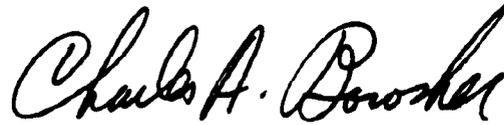
The DCAA resident auditor responsible for preparing the March 1982 report informed us in January 1984 that he was aware that the methods used in the report departed from the traditional DCAA approach. He said the purpose of his report was to focus attention on what he believed were excessive wage rates in the aerospace industry. We agree that an important unanswered question is whether the total compensation paid in the aerospace industry is reasonable. In a separate review pursuant to your request, we are examining total compensation packages that would include labor rates and fringe benefits in the defense aerospace industry in relation to available data on employees in other industries. This review is now underway and should help address

the fundamental issue raised in DCAA's March 1982 report. We also have underway a review of DCAA audit planning, scheduling and execution with emphasis on forward pricing and incurred cost audits and the use made of the DCAA reports.

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We are sending copies of this report to the Chairman, Subcommittee on Investigations, House Committee on Armed Services, who also requested that we review the validity of the DCAA report. We are also sending copies to the Secretary of Defense; the Director, Defense Contract Audit Agency; the Director, Defense Logistics Agency; and the President, Government Products Division, Pratt and Whitney Aircraft Company.

Sincerely yours,



Comptroller General
of the United States

Enclosures

EVALUATION OF DCAA REPORT ON ENGINEERING LABOR RATESBACKGROUND

On January 29, 1982, prior to negotiations with Pratt and Whitney, the Air Force administrative contracting officer followed normal procedures and requested DCAA to provide an evaluation of the reasonableness of Pratt and Whitney's proposed labor rates for a planned forward pricing rate agreement for 1982, 1983 and 1984. DCAA's report was intended to be used by the administrative contracting officer in negotiating reasonable labor rates for the forward pricing agreement.

Forward pricing labor rate agreements are negotiated written agreements between contractors and the government which establish projections of labor rates to facilitate pricing anticipated contracts during specified future periods. They are administrative tools used to reduce the time and costs associated with contract negotiations between contractors and the government by establishing labor rates for future periods to be used by the contractor for preparing proposals and by the government for evaluating them.

On March 13, 1982, DCAA reported to the administrative contracting officer that Pratt and Whitney's actual labor rate increases in 1981 and the increases proposed for 1982 through 1984, would result in excessive costs for labor (both direct and indirect) and profit of more than \$155 million for the 4 year period 1981 to 1984.

The DCAA report stated that it was based on the following considerations:

- Government contractors should lead private industry in .
restraining spending particularly in the area of labor
costs where they have almost absolute control.
- Contractor labor rates should be managed judiciously so
that escalation approximates a midpoint range between
private industry rates and those of Federal employees.
- Pratt and Whitney's failure to control labor rates adds
to the bidding up of labor costs in the defense industry
and contributes to labor inflation throughout the
economy.
- Lack of fiscal responsibility with regard to labor costs
could eventually lead to the downfall of the defense
industry in the face of international competition.

Officials in DCAA's Atlanta Regional Office reviewed the March 1982 report and the report was reissued to the administrative contracting officer in April 1982 after some language in the report was moderated. In June 1982 Pratt and Whitney updated its proposal to reflect a reduction in its proposed labor rates, and the updated rates were also evaluated by DCAA. The resulting DCAA report was provided to the administrative contracting officer in August 1982. Although changes were made to the original March 1982 report to reflect later information, DCAA's recommendations, conclusions and methodology remained essentially unchanged in all three reports. Consequently, for the sake of clarity, our comments are referenced to the DCAA March 1982 report only.

While there is currently considerable controversy surrounding the DCAA report, the Director of DCAA's Atlanta Region, in a July 16, 1982, memorandum to the DCAA Director made the following comments about the report.

"The data is forwarded to you to show what we believe is a good effort on the field office's part to aid officials responsible for negotiating forward pricing rates. What we view as particularly beneficial is data provided the local contracting officer relative to national trends and the cost impacts (cumulative) of proposed contractor actions. We believe this type visibility may be helpful at other locations where contractors may be proposing large increases in the currently changing environment."

The Director of the Atlanta Region said that when he wrote the memorandum, he had in mind the audit staff's research pertaining to (1) the private sector labor rate indices to show what was happening in the market place, and (2) the changing inflationary environment and national trends. He said that he also felt that the graphs which compared labor indices for the private sector and government were meaningful information.

DCAA'S CALCULATION
OF THE 18.8 PERCENT

The March 1982 report stated that there was an 18.8 percent increase in the average engineering department labor rate for Pratt and Whitney from 1980 to 1981. The 18.8 percent is the difference between the composite average labor rate for three dissimilar skill and pay levels of employees, and was not adjusted to eliminate the effects of changes in the proportion of hours worked by higher paid engineers compared to lower paid technicians from 1980 to 1981. As a result, the 18.8 percent

figure is higher than the 1981 labor rate increases for Pratt and Whitney's three separate engineering department categories of labor (15.2 percent for technicians, 15.0 percent for engineers, and 14.1 percent for managers) by 3.6, 3.8, and 4.7 percentage points, respectively.

The following table shows DCAA's calculations of the composite increase of 18.8 percent in the average labor rate for the engineering department. Because Pratt and Whitney considers actual labor rate data to be proprietary, we adjusted the data. However, the data reflect the same relationships and variances as the actual data for labor hours and rates.

Labor ¹ Category	1980			1981			Percent Increase
	Salaries	Hours	Average Hourly Rate	Salaries	Hours	Average Hourly Rate	
Technicians	\$ 1,861	292	\$ 6.37	\$ 1,483.50	202	\$ 7.34	15.2
Engineers	6,767	630	10.74	7,734.20	626	12.35	15.0
Managers	1,372	78	17.59	1,505.60	75	20.07	14.1
	<u>\$10,000</u>	<u>1,000</u>	\$10.00	<u>\$10,723.30</u>	<u>903</u>	\$11.88	18.8

¹Pratt and Whitney's Engineering department labor pool is comprised of three categories of labor—salary nonexempt (engineering technicians), salary exempt (engineers), and treasury (management engineers). Exempt and nonexempt refers to the requirements of the Fair Labor Standards Act.

Relying on Pratt and Whitney data which aggregated the total salaries and hours worked by the three labor categories in the engineering department, DCAA compared the average 1980 hourly rate of \$10 (\$10,000 in total salaries received divided by the 1,000 total hours worked) to the corresponding 1981 rate of \$11.88 (\$10,723.30 in total salaries received divided by the 903 total hours worked). The increase of \$1.88 in the overall average hourly rate from 1980 to 1981 represented an 18.8 percent increase.

The composite 18.8 percent increase is arithmetically correct. It should have been adjusted, however, to eliminate the effects of significant proportional changes in the hours worked in the different labor categories before making any comparison with BLS nationwide averages. For example, the total hours worked by the lower paid technicians decreased by 30.8 percent and the hours worked by engineers and managers decreased by only .63 and 3.8 percent, respectively. The DCAA resident auditor told us that he was aware that there was a change in the skill mix, but he did not consider it significant in making his calculation. He believed that the nature of the

work had not changed to require a higher proportion of skilled engineers and attributed the significant decrease in technicians to layoffs because of declining business.

The computation of average labor rate increases is very sensitive to changes in the number of hours worked by the various labor categories. To illustrate, if the number of hours worked by technicians had increased by 30.8 percent rather than decreased by that amount, without any change in individual labor rates, the composite increase for 1980-81 would have been only 11.2 percent rather than 18.8 percent. Conversely, the composite rate would have been higher than the 18.8 percent if the hours worked by technicians had decreased further.

Because the actual increases in Pratt and Whitney's average labor rates in 1981 were high in relation to the nationwide BLS indices for engineers in the private sector, we reviewed increases in prior years for engineers² to determine if this was a trend at Pratt and Whitney. The following table compares increases at Pratt and Whitney for engineers with increases in nationwide BLS averages from 1977 to 1981.

Comparison of Annual Percent Increase
in Average Engineering Labor Rates

	1977 to <u>1978</u>	1978 to <u>1979</u>	1979 to <u>1980</u>	1980 to <u>1981</u>
Pratt and Whitney	7.2	5.8	8.0	15.0
Nationwide BLS average	9.0	8.4	9.8	10.9

The relatively high increase in Pratt and Whitney's 1981 average labor rate shown above was due primarily to a 7-percent general salary increase in January 1981 plus merit increases averaging 7 percent in that year. There was no general salary increase in 1980. Previous general salary increases were given in December 1979 (4 percent) and in September 1978 (3 percent). Pratt and Whitney officials stated that factors influencing their 1981 decision were (1) double digit inflation during 1979-80, (2) the high average starting salaries that had to be provided to college graduates with engineering and science degrees relative to salaries for employees with 1 or 2 years experience, and (3) a recent settlement with the machinists union representing hourly workers. Pratt and Whitney officials could not provide us with any supporting documentation to show how they arrived at the 14 percent merit and general salary increases in 1981.

²This analysis includes only engineers (salary exempt category) and not technicians or managers. Engineers accounted for about 65 percent of engineering labor costs in 1981.

DCAA'S ESTIMATE OF \$155 MILLION IN
EXCESSIVE COSTS AND RECOMMENDED ADJUSTMENTS

DCAA concluded that increases in Pratt and Whitney's labor rates in 1981 and increases proposed for 1982, 1983, and 1984 for the forward pricing rate agreement would result in excessive costs to the government of over \$155 million. That estimate was based on the difference between (1) labor rate increases experienced by Pratt and Whitney for 1981 along with increases proposed by Pratt and Whitney for 1982, 1983, and 1984, and (2) DCAA's estimates of reasonable increases for the 4 years. This difference was then applied to constant labor hour totals for each of the 4 years. For purposes of illustration, these differences for Pratt and Whitney engineers are shown below.

	<u>Percentage increases</u>			
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Pratt and Whitney actual increase ³	15.0	-	-	-
Pratt and Whitney proposed increases ⁴	-	8.2	15.1	12.7
DCAA's estimate of reasonable increases	<u>9.0</u>	<u>6.7</u>	<u>7.3</u>	<u>6.8</u>
Difference (percentage points)	<u>6.0</u>	<u>1.5</u>	<u>7.8</u>	<u>5.9</u>

DCAA made similar calculations for Pratt and Whitney's other labor categories such as manufacturing, and then calculated the total excessive costs, including indirect labor and profit for each of the 4 years, as follows.

<u>Year</u>	<u>Dollar amount</u>
1981	\$ 15,354,657
1982	23,438,412
1983	46,655,280
1984	<u>70,003,871</u>
	<u>\$155,452,220</u>

³The 15 percent used in the computation is the actual increase experienced by Pratt and Whitney engineers only. The 18.8 percent composite rate discussed beginning on page 6 was used inappropriately by DCAA in offsetting proposed rates for 1982 and 1983 (see p. 10).

⁴Pratt and Whitney's actual average engineering labor rate increased by 8.1 percent in 1982 and by 5.9 percent through November 30, 1983.

The \$155 million estimate of excessive costs was mathematically correct. However, the \$155 million estimate was based on a comparison of Pratt and Whitney experienced and proposed increases with an average of similar increases for private industry and the Federal government. As explained on page 11, the use of Federal increases, which resulted in lowering the average increase used in the comparison, was a departure from DAR guidance. If this guidance had been followed, the estimate would have been reduced by about \$30 million. Moreover, the estimate was based on an assumption that the government would accept the labor rates proposed by Pratt and Whitney without modification (see p. 12). Finally, while relatively large increases in labor rates can lead to unreasonably high labor costs, a conclusive determination and comparison can only be made by examining the total compensation package from year to year. The DCAA report focused on increases in labor rates rather than total compensation. Use of total compensation data could materially increase or reduce DCAA's estimate of excessive cost.

We believe that DCAA's estimate is questionable, because in its computation DCAA departed from established practices and because it made assumptions which did not reflect adequate consideration of the underlying uncertainties.

Because DCAA believed that Pratt and Whitney's labor increases were excessive in 1981, it recommended that 1982 and 1983 increases for the forward pricing rate agreement be limited to offset the excessive costs. The following table shows how DCAA recommended limiting labor rate increases in the forward pricing rate agreement for the engineering department to offset the 1981 excessive costs.

	<u>Percentage increases</u>			
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
DCAA's estimate of reasonable increases	9.0	6.7	7.3	6.8
DCAA's calculated actual increase	18.8	-	-	-
DCAA's recommended increases	-	<u>2.5</u>	<u>2.5</u>	<u>6.8</u>
Amount to be offset	<u>(9.8)</u>	-	-	-
Amount offset		<u>4.2</u>	<u>4.8</u>	<u>-0-</u>

In summary, DCAA recommended significantly lower rate increases than proposed by Pratt and Whitney for the forward pricing rate agreement. In our view, DCAA's recommendations were not appropriate given (1) the purpose and nature of forward pricing agreements (see p. 12), and (2) the questions that can be raised about DCAA's estimate of excessive costs.

The DCAA resident auditor responsible for preparing the March 1982 report informed us in January 1984 that he was aware that the methods used in the report departed from the traditional DCAA approach. He said the purpose of his report was to focus attention on what he believed were excessive wage rates in the aerospace industry. We agree that an important unanswered question is whether the total compensation paid in the aerospace industry is reasonable. In a separate review, we are examining the industry's compensation packages.

LABOR RATE INCREASES LINKED TO
INCREASES FOR GOVERNMENT EMPLOYEES

DCAA's estimates of reasonable increases in Pratt and Whitney's engineering labor rates were based on simple averages of its estimates of actual increases for government employees and for engineers and engineering technicians in the private sector as a whole for 1981 and projected increases for 1982, 1983, and 1984 as shown below.

	<u>Percentage increases</u>			
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Government increases	8.0 ^a	5.4	6.6	5.5
Private sector increases	10.0 ^b	8.0	8.0	8.0
DCAA's estimate of reasonable increases	9.0	6.7	7.3	6.8

^a/ DCAA's estimated government increase of 8.0 percent differs from our 8.7 percent increase shown on page 13, because DCAA weighted the effects of pay increases granted in October 1980 and 1981, while we used published BLS data without adjustment.

^b/ This 10.0 percent escalation rate differs from the BLS 10.9 percent rate shown on page 13, because DCAA included both engineers and engineering technicians in this calculation.

DAR 15-205.6, which is included in an appendix to DCAA's Contract Audit Manual, provides that compensation paid by a contractor is reasonable to the extent that it is based on the contractor's established policy and conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area for similar services. This DAR provision does not provide for the use of increases in labor rates for government employees as criteria for determining the reasonableness of increases in contractors' labor rates.

Officials in DCAA's Atlanta region informed us that guidance to its auditors does not call for using increases in

government labor rates as criteria for evaluating the reasonableness of increases in contractor labor rates. Also, they informed us that none of the other audit reports they reviewed or DCAA offices they visited used this technique to question labor costs.

ADMINISTRATIVE CONTRACTING OFFICER
DID NOT ACCEPT 1983 AND 1984 INCREASES
PROPOSED BY PRATT AND WHITNEY

In February 1982, pending DCAA's review of the labor rates proposed by Pratt and Whitney, the administrative contracting officer recommended--based on his own evaluation of the proposal--that procuring agencies use the proposed rate increase of 8.2 percent in negotiating contracts with Pratt and Whitney for 1982, but lower rates than those proposed for 1983 and 1984. For example, the administrative contracting officer recommended increases in average general engineering labor rates of 9.7 percent and 9 percent for 1983 and 1984, respectively as compared to the increases proposed by Pratt and Whitney of about 15.1 percent for 1983 and 12.7 percent for 1984.

Subsequently, as a result of the problems relating to the DCAA report, the administrative contracting officer at Pratt and Whitney did not attempt to negotiate the rates recommended by DCAA. A forward pricing agreement has not been negotiated with Pratt and Whitney since 1980. A Pratt and Whitney official told us that a forward pricing rate agreement had not been negotiated because Pratt and Whitney's position and that of the government are too far apart.

Relatively lower increases (8.1 percent in 1982 and 5.9 percent through November 30, 1983) were experienced by Pratt and Whitney. We did not inquire into the reasons for these lower increases. The DCAA resident auditor believes these lower rates were influenced by the DCAA audit report.

FORWARD PRICING RATE AGREEMENTS
ARE NOT BINDING

DCAA recommended that labor rate increases for the forward pricing rate agreement be limited to take into account government-wide pay increases in 1982, 1983, and 1984 and to offset excessive costs incurred by the government under contracts in 1981. This recommendation does not adequately recognize the purpose and nature of a forward pricing agreement.

Forward pricing rate agreements are written agreements between contractors and the government to make projections of

costs such as labor rates available for pricing contracts during specified periods. DAR 3-807.8 provides that the agreements (1) are not binding and can be rescinded by either party at any time for any reason, and (2) do not relieve contractors from the responsibility of basing contract proposals on current, complete, and accurate cost or pricing data as required by other sections of the DAR and Public Law 87-653 (Truth-In-Negotiations Act). Therefore, if a forward pricing rate agreement does not reflect current, complete, and accurate cost or pricing data at the time a specific contract is negotiated, neither the contractor nor the government should use it to price the contract.

COMPARISON OF CONTRACTOR,
PRIVATE SECTOR AND GOVERNMENT
LABOR RATE INCREASES

As shown by the following table, average increases in Pratt and Whitney's labor rates for engineers⁵ and the average rates of the other four contractors we visited were generally in line with one another and with the BLS indices for the private sector for 1977 to 1981. Pratt and Whitney rates for 1981 were substantially higher than three of the four contractors and higher than the private sector BLS index. For the four contractors for which data was available for the entire period, increases were higher than the federal employees' average increases for 1977 to 1981.

Comparison of Average Engineering
Labor Rate Increases

	<u>1977</u> to <u>1978</u>	<u>1978</u> to <u>1979</u>	<u>1979</u> to <u>1980</u>	<u>1980</u> to <u>1981</u>	<u>Average</u> <u>annual</u> <u>increase</u>
Pratt and Whitney	7.2	5.8	8.0	15.0	9.0
Contractor A	5.8	6.0	10.2	16.0	9.5
Contractor B	5.2	3.9	8.3	12.7	7.5
Contractor C ^{a/}	-	-	11.8	7.7	9.8
Contractor D	8.6	10.3	8.5	9.0	9.1
Nationwide BLS average	9.0	8.4	9.8	10.9	9.5
Federal government ^{b/}	7.3	5.5	6.6	8.7	7.0

^{a/} Data was not readily available for the entire period at contractor C.

^{b/} Percentage increases apply to all categories of Federal workers, including engineers.

⁵As with the table on page 8, this analysis includes only engineers, and not technicians and managers.

We did not review the overall reasonableness of labor rates or total compensation packages at these contractors.

The contractor and BLS labor rate data are not precisely comparable. For example, nationwide BLS increases and contractors A and C are based on March data of each year, but the increases for contractor B are based on July data and the increases for contractor D are based on October data. However, we do not believe the variations in reporting dates significantly affect the results of the comparisons.

OTHER CONTRACTING OFFICERS USE
DCAA LABOR RATE RECOMMENDATIONS

We found that the administrative contracting officers at three of the four additional contractors we visited used DCAA's assistance and recommendations during labor rate negotiations with contractors. (One of the four contractors, contractor C, has elected not to have a forward pricing agreement for labor.) Also, the rate agreements that were negotiated were consistent with DCAA recommendations. In fact, at contractor D, a DCAA auditor negotiated the forward pricing agreement with the approval of the administrative contracting officer. At contractor A, the administrative contracting officer accepted the contractor's proposed labor rates even though they were slightly higher than DCAA's recommended rates. DCAA agreed with the administrative contracting officer's actions because the rates were close to its estimates.

DCAS REPORT ON PRATT AND WHITNEY
EMPLOYEE COMPENSATION

In May 1982 the administrative contracting officer at Pratt and Whitney asked the Defense Contract Administration Service (DCAS) to perform an employee compensation system review because the contracting officer was unable to use the March 1982 DCAA report in negotiations. DCAS is an agency within DOD that provides contract administrative services to Federal agencies, such as performing wage rate studies at contractors' plants. On November 29, 1982, DCAS reported among other findings, that increases in the average engineering salaries at Pratt and Whitney exceeded nationwide increases reported by BLS for 1979, 1980, and 1981.

While the DCAS report dealt with total compensation, it did suggest a possible difference with our findings concerning increases in engineering labor rates. We met, therefore, with DCAS officials to determine the reasons for the differences. We found that the DCAS conclusion on increases in engineering

salaries was based on a judgmental sample involving 84 employees which, in addition to engineers, included file clerks, draftsmen, budget analysts and others. In light of the composition and size of the DCAS sample, we believe DCAS's conclusion was invalid with regard to increases in the average engineering salaries.

OBJECTIVES, SCOPE, AND METHODOLOGY

As agreed with the Subcommittee, we limited our objectives to reviewing (1) DCAA's reported 18.8 percent increase in the average engineering labor rates at Pratt and Whitney in 1981, (2) the validity of DCAA's reported \$155 million in excess costs to be incurred by the government during the period 1981-84, (3) whether increases in engineering labor rates at Pratt and Whitney and at four other contractors were excessive in relation to the increases for government and other private sector employees as reported by BLS, and (4) whether the administrative contracting officers utilized DCAA's findings and recommendations in negotiating forward pricing labor rate agreements. The contractors selected were large companies substantially involved in government work and located in the southeastern part of the United States.

We interviewed administrative contracting officers; DCAA, DCAS and contractor officials; and the resident auditor primarily responsible for the DCAA report. We also determined the extent to which administrative contracting officers utilized the DCAA reports in negotiating forward pricing labor rate agreements at the four other contractors. We did not obtain agency and contractor comments on this report.

We also reviewed (1) DCAA's follow-on April and August 1982 reports on labor rate increases at Pratt and Whitney to determine if they were based on the same rationale and methodology as the March 1982 report, (2) the DCAS report of November 1982 on a compensation study at Pratt and Whitney, and (3) the DAR and the DCAA Audit Manual.

We made our review in accordance with generally accepted government auditing standards.