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

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SEP 10 1977

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate

Dear Mr. Chairman:

In accordance with your letters dated June 9, 1977, and July 21, 1977, we have reviewed the costs of compliance with the Renegotiation Act of 1951, as amended (50 U.S.C. App. 1211 et. seq.), claimed to have been incurred by selected contractors, as well as studies by the Renegotiation Board and two industry associations. As requested, our work was conducted at the following activities: Hewlett-Packard Company; FMC Corporation; Teledyne, Incorporated; Eaton Corporation; Cutler-Hammer, Incorporated; Fairchild Industries; John Fluke Manufacturing Company; Barnes Engineering Company; Financial Executives Institute; and the Renegotiation Board. In addition, we visited the Aerospace Industries Association of America to review their survey of compliance costs, and the firms of Astrosystems; Hopeman Brothers, Incorporated; and Martin Marietta Corporation, in connection with our evaluation of the Board's study.

Our specific objective was to ascertain if, as claimed by contractors, there were substantial costs incurred for complying with the requirements of the Renegotiation Act. We also evaluated studies prepared by the Renegotiation Board and industry associations attempting to determine the extent of such costs.

In general, we have concluded that some costs are necessarily incurred by contractors to comply with Renegotiation Act requirements. We are unable, however, to determine the magnitude of such costs or to what extent they are incremental to other financial data costs. The primary problem in determining and verifying such costs was that the contractors' accounting systems are not designed to identify and segregate such data.

It is important to note that because of unusual aspects of the firms covered in this review, any conclusions drawn from the data are unlikely to be representative of the approximately 3,000 firms that file with the Board. To illustrate: One contractor, Hewlett-Packard, claims and obtains exemptions for about 75 percent of its otherwise renegotiable sales. Under

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the Act, contractors can claim exemptions for standard commercial articles, standard commercial classes, and new durable productive equipment for otherwise renegotiable sales to the Government. This contractor accounts for 8 percent of all exemptions granted to all firms. The large amount claimed is costly to document. Also, seven of the eight contractors in our sample were assigned by the Board for field review. This process is also more costly than a simple filing since a field review requires the submission of substantial, additional data. The high representation of contractors reviewed in the field is unusual since only about 20 percent of companies filing fall into this category.

Our major observations are summarized below. Detailed reports of the results of our work at each of the locations we visited or contacted are included in enclosures 1 and 2.

THE NATURE OF INDUSTRY EFFORT TO COMPLY WITH THE RENEGOTIATION ACT

Complying with the requirements of the Renegotiation Act requires continuing effort on the part of Government contractors. All the companies reviewed perform some or all of the various tasks during the year relating to: identifying renegotiable sales; preparing and filing applicable reports; responding to Board requests for additional data if assigned for field review; and, in some cases, protesting a Board determination of excessive profits.

For the most part, these efforts involve a number of contractor employees at many corporate levels who spend a small amount of time on renegotiation matters. If the Renegotiation Act was repealed, in most cases only a few positions would be eliminated. In this situation, companies presumably would find alternative work for employees relieved of renegotiation tasks.

AN EVALUATION OF THE COSTS OF COMPLIANCE OF SELECTED CONTRACTORS

Contractor costs of compliance were mainly estimates that, in most cases, were backed up where feasible with various types of supporting data. The range of these cost estimates was $16,600 to $1.7 million annually. (See page 1 of enclosure 1.) Generally, we were only able to verify the accuracy of a part of the cost figures submitted. The corporate accounting systems we reviewed did not provide for the identification of costs of renegotiation functions. Estimates were based largely on employee recollection; and, in some instances, little or no records were maintained.

Regardless of how meticulous each contractor was in preparing its estimate of costs incurred in complying with renegotiation, none of the costs was recorded on a daily basis by the person or persons involved in the activity. Generally, it was necessary for the employees or their supervisors to estimate the amounts of time many months after the time was expended. In such instances, while we could verify salaries and associated costs, we were often unable to find any verifiable, objective evidence to support the time spent. Generally, a relatively minor part of the costs claimed to have been incurred by contractors represented the costs incurred to obtain professional assistance of experts and consultants outside the contracting organization. These were verified by us to actual billings and confirmation with suppliers where feasible.

Much of the cost of compliance estimate of the AIL Division of Cutler Hammer, Inc., and the Eaton Corporation appeared fairly reasonable, except that we could not verify various time estimates of employees engaged in renegotiation activities. We also had this problem in reviewing the Hewlett-Packard Company's cost estimate as discussed on p. 6.

The FMC Corporation did not maintain records or provide sufficient details on the composition of its estimate of the cost associated with renegotiation matters to enable us to evaluate its estimate. Two other companies could not provide us with their costs of compliance. An officer of Teledyne, Inc., advised that his estimate used in recent Senate Banking, Housing and Urban Affairs Committee hearings was based on personal experience, intuition, and discussions with members of the Financial Executives Institute. Estimates of the cost of compliance were not available at Fairchild Industries and could not be prepared within the time frame of our review.

In two instances, cost estimates were overstated. The companies involved were Barnes Engineering Company and John Fluke Manufacturing Company. Barnes' overstatement was for costs incurred for resubmitting and redoing information previously submitted to the Board. After our review of the filing instructions and consultation with the Board, we determined that Barnes did not have to submit this information.

In the case of Fluke Manufacturing Company, in the process of verifying the cost estimate, we found that certain key elements were unrealistically high.

Industry associations such as the Financial Executives Institute and the Aerospace Industries Association of America, Inc., declined, as a matter of policy, to identify participating companies involved in their cost of compliance surveys or to provide any details related to individual participants. Therefore, we were unable to evaluate their estimate of the cost of complying with the Renegotiation Act.

Are costs of compliance proportional to volume of sales?

Based on the estimates of compliance costs prepared by contractors, it would appear costs are not proportional to renegotiable sales. Costs can increase or decrease depending on:

1. The size of individual contractors or subcontractors.

2. The number of segments, e.g., cost centers, profit centers, plants or divisions receiving renegotiable business.

3. The amount of exemptions from renegotiation that is claimed and needs to be documented.

4. Whether a contractor's filing is (a) cleared without field review, (b) reviewed in the field but later determined not to have made excessive profits, or (c) reviewed in the field and determined to have made excessive profits. Field review generally requires additional schedules and further breakdowns of the data in the contractor's filing. A finding of excessive profit frequently entails additional paperwork plus the engagement of outside legal and accounting assistance.

5. The extent to which the contractor makes use of automated data processing in its recordkeeping activities.

AN EVALUATION OF WHAT THE RENEGOTIATION BOARD SAID IT IS COSTING INDUSTRY TO COMPLY

An analysis of the cost of filing was prepared by the Renegotiation Board in March 1977 for the Office of Management and Budget. This study estimated that the average contractor cost to file was about $3,300. We were informed by the Board that its estimated cost represents the cost per individual filing. When a company with a divisional corporate structure files a report, the Board counts this as a single filing. But when a company that has subsidiaries files an RB-1 report, each subsidiary must also file a report. These filings are counted as separate filings by the Board. The indicated cost estimates by the Board for the three firms in its analysis are just for the parent companies and do not include the filing cost for any subsidiaries. For example, we were told that the Board's estimate of $325 for Hopeman Brothers does not represent the filing costs of its four subsidiaries. When those subsidiaries are considered, the total filing costs for Hopeman Brothers in the Board's analysis should be $845. We have evaluated the analysis and present the following observations.

The Renegotiation Board developed the estimate of contractor costs of compliance by selecting three contractors that it believed were representative of the small, medium, and large contractors performing renegotiable business. None of the contractors was made aware of the fact that it was included in the study and none was asked by the Board what it estimated its individual costs of compliance to be. The estimate of contractor costs was made solely on the knowledge casually picked up by Renegotiation Board personnel during their prior contacts with respect to the contractor's filing. Some consideration was given to whether a contractor was assigned for field review or cleared without assignment and the probable volume of contractors falling into each size category.

We do not believe, and the Renegotiation Board agrees, that a sample of three contractors out of approximately 3,000 annual filings is a representative sample of the population.

There are indications that the amount of costs ascribed to the small and medium contractors is understated because it does not contain provision for all the types of costs that contractors claim to incur to comply with the Renegotiation Act. For the most part, the Board's analysis appeared to limit the costs to those incurred for personnel directly involved in preparing the basic filing document, RB-1 (Standard Form of Contractor's Report). We believe it is reasonable to assume that some cost is incurred, for example: in identifying sales as renegotiable or nonrenegotiable; contacting customers if purchase documents are unclear with respect to renegotiation; recording such sales and related costs; and building up schedules and data to support exemptions if taken. We saw no indication that such costs were provided for in the Board's estimates.

We also noted that the Board assumed that 80 percent of each category of contractors would be cleared without assignment and 20 percent would be assigned to its field offices for more detailed examination. While the 80/20 distribution may be accurate with respect to all filings, it is not necessarily accurate for each category. We brought this to the Board's attention during our review and Board personnel provided the actual distribution in each category for FY 1976. They also informed us that the more accurate distribution was not available to them at the time they prepared their study. Utilizing the same Renegotiation Board estimates of contractor costs, this change in distribution caused the weighted average estimate of contractor cost to decrease to $1,880.

In addition, the Board informed us that its estimates of cost of compliance are a cost per filing rather than the total cost per contractor when more than one filing is required because the contractor has subsidiaries with renegotiable sales.

We made available to a Renegotiation Board member a copy of the sections of this report dealing with the Board's analysis. His comments were considered in the report.

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Hewlett-Packard Company

During recent Senate Banking, Housing and Urban Affairs Committee hearings on the Renegotion Reform Act of 1977, the Hewlett-Packard Company chairman, in testimony, presented various estimates on what it costs his company yearly to comply with the Renegotiation Act. In subsequent testimony, the Chairman of the Renegotiation Board questioned these figures and charged that the compliance cost claimed by the company was erroneous.

As requested, we reviewed the cost of compliance estimates at the Hewlett-Packard Company. We conclude that

--the company's approach to developing the estimate appeared reasonable;

--there was a substantial amount of supporting detail for the estimate; and

--while we were unable to validate the costs claimed because of time and documentation limitations, we found the company does expend considerable effort and costs in filing with the Board.

During the hearings, the Chairman of the Renegotiation Board also argued that the information supplied to the Board by Hewlett-Packard Company is the same as information accumulated for compliance with the Truth-in-Negotiation Act (Public Law 87-653), and that there is no additional cost of complying with the Renegotiation Act. We found, however, that the provisions and requirements of the Renegotiation Act are significantly different from those of other laws, such as the Truth-in-Negotiations Act, and that separate procedures are needed in order to satisfy the requirements of the Renegotiation Act.

We gave each of the contractors we reviewed a summary of our findings. Informal or written comments were received and considered in developing this report. Copies of all written comments are included in enclosure 1. In most cases, the contractors agreed with the facts presented. Hewlett-Packard, however, was disappointed that we could not state an opinion as to the reasonableness of its costs.

We trust the above information and enclosures are responsive to your needs. If we can be of further assistance, please let us know.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Enclosures

ENCLOSURE 1

RESULTS OF REVIEW OF INDIVIDUAL COMPANY AND INDUSTRY ASSOCIATION ESTIMATES OF THE COSTS OF COMPLIANCE WITH THE RENEGOTIATION ACT

CONTENTS

SUMMARY SCHEDULE OF CONTRACTORS REVIEWED

Firm	Sales for fiscal year	Total sales (in millions)	Amount of renegotiable sales (in millions)	Does firm claim any exemptions?	Was the firm recently assigned?	Firms' estimated cost of compliance: Annual filing of RB-1 and support documents	Firms' estimated cost of compliance: Additional cost when assigned for a field review
Barnes Eng. Co.	1976	$ 10.6	$ 7.2	No	No	a/$ 16,600	Not applicable
Cutler-Hammer, Inc.	1975	318.7	95.5	No	Yes	23,360	$ 58,019
Eaton Corp.	1975	1,558.3	4.1	b/Yes	Yes	16,465	1,755
Fairchild Industries	1975	193	124	No	Yes	Data not available	
John Fluke Mfg. Co.	1976	49.2	9.3	f/Yes	Yes	g/37,112	h/4,275
Teledyne, Inc.	1975	1,551	408	No	Yes	Data not available	
FMC Corp.	1975	2,020	106	Yes	Yes	923,400 to	c/e/1,715,000
Hewlett-Packard Co.	1975	981.2	126	d/Yes	Yes	198,000 to	e/247,000

a/Estimate overstated by a substantial part of a $3,800 cost element (see pages 4 and 5, enclosure 1).

b/$460,000 claimed in exemptions.

c/Due to limitations on our work, we could not verify the accuracy or reasonableness of any of FMC's cost estimates.

d/$97 million are claimed in exemptions.

e/These costs are for both filing the RB-1 and supplying additional information regarding an assignment.

f/$4.5 million claimed under standard commercial article exemption.

g/Estimate overstated by $19,733 based on our review. At the conclusion of our review, Fluke provided us with revised estimate of $20,506.

h/Estimate overstated by $1,400.

BARNES ENGINEERING COMPANY

BACKGROUND

Barnes Engineering Company designs, develops, and produces infrared and electro-optical systems, instruments and components for use in space exploration, defense, research, industry and the natural sciences. Products include detectors, optical alignment instruments, remote sensing instruments, analytical accessories, and medical, military and space instrumentation. The company is headquartered in Stamford, Connecticut, with plants in Stamford and Waltham, Massachusetts.

The company had sales revenues of approximately $10 to $13 million per year during the last 5 fiscal years. Fiscal year 1976 sales were $10.6 million. It has not applied for or taken any exemptions during this time. Its past reports to the Renegotiation Board have never been assigned to a regional board for field review. According to company officials, approximately 30 percent of yearly sales are entirely commercial and not subject to renegotiation. The remaining 70 percent represents both prime and subcontract government sales. Of the $7,201,891 renegotiable sales reported in FY 1976, $5,181,653 represented subcontracts.

COST OF COMPLIANCE

Barnes estimates it cost approximately $16,600 to comply with the filing requirements of the Board for FY 1976. Company officials maintain this figure is representative of a yearly cost. The cost estimate is based on the judgment of the financial vice president. Estimates of the time spent on compliance were developed by the individuals involved and costed out on a direct compensation basis with no overhead considerations. Because they are estimates, we were unable to trace these costs to company financial records. Following is a breakout of Barnes' estimated annual cost of compliance.

Cost elements	Annual cost
Legal	$ 2,000
Marketing	1,000
Accounting	750
Financial	1,550
EDP	4,500
Report Preparation	3,000
Miscellaneous	3,800
Total	$16,600

Legal Cost--Cost estimated for review of reports, regulations and contracts by the company's attorney with some outside consultation. The estimate is 4 percent of the company's annual legal costs based on the estimated percent of time spent on renegotiation matters by the company's in-house attorney. Barnes contends it would not incur these costs, with the exception of the legal review of all government contracts, if there were no compliance requirements.

Marketing Cost--Cost estimated for transferring information on orders that appear to be commercial, but later are determined to be subject to renegotiation. This estimate represents 3 hours per week for retyping and reprocessing. This cost would not be incurred if there were no reporting requirements.

Accounting Cost--Cost estimated for public accounting review of information contained in reports to the Board. Cost is based on 1-1/2 days of time charges. This cost, according to the company, would not be incurred if there were no reporting requirements.

Financial Cost--Cost estimated for maintenance of regulation data and review of data and reports by the financial vice president. The basis of this estimate is 2 weeks per year of his time. Much of this cost would still be incurred because the review of regulations and reports pertain to other agencies in addition to the Board.

EDP Cost--Cost estimated for processing and reprocessing information for compliance. The estimate is 3 percent of total EDP costs, based on 1-1/2 weeks per year per person, or 3 percent of the person's total annual time. Barnes maintains most of these costs would not be incurred if there were no compliance requirements.

Report Preparation--Cost estimated for development of data, regulation review, and report preparation by the comptroller. The estimate is based on 1-1/2 months of the comptroller's time. Much of this cost would be incurred if there were no compliance requirements because the time spent was also in conjunction with in-house and other Federal reports.

Miscellaneous Cost--Cost estimated for resubmitting and redoing information previously submitted to the Board. The majority of this estimate for FY 1976 is for submitting information to support a Statement of Non-Applicability. After a review of the filing instructions and consultation with the Board, we determined that Barnes did not have to submit this statement or its support. We brought this matter to Barnes' attention and were told this will materially reduce the estimate for this category of costs.

Summary

The cost of compliance developed by Barnes is an estimate. The figure of $16,600 is overstated by a substantial part of the $3,800 estimate for miscellaneous expenses. Only a portion of the remainder of Barnes' estimated costs would be incurred if there were no filing requirements. However, we were unable to determine what portion of those estimates could be considered incremental.

CUTLER-HAMMER, INC.

BACKGROUND

Cutler-Hammer, Inc. (C-H) is a diversified international electronics company headquartered in Milwaukee, Wisconsin. It designs and produces electrical/electronic equipment and aerospace systems and subsystems for industry, commerce, and Government. It has 30 production and/or research facilities in the United States and 17 plants in 13 other countries.

From 1972 through 1975, C-H reported to the Renegotiation Board sales that averaged about $290.5 million annually--of which about $93.4 million or 32.1 percent was reported as renegotiable sales. Its AIL Division in New York was responsible for about $84.1, million or 90 percent, of the renegotiable sales. We visited the AIL Division and prepared a separate summary of its estimated cost of compliance with the Renegotiation Act. (See p. 13). C-H companywide and AIL Division sales for fiscal years 1972 through 1975 are shown below:

	C-H companywide sales			AIL Division sales			
Year ended Dec. 31	Total (Millions)	Renegotiable (Millions)	Percent renegotiable	Total (Millions)	Renegotiable (Millions)	Percent renegotiable	Percent of companywide renegotiable
1972	$249.1	$86.4	34.7	$ 89.4	$79.5	88.9	92.0
1973	282.1	94.1	33.4	97.2	87.1	89.6	92.6
1974	312.2	97.5	31.2	103.1	88.9	86.2	91.2
1975	318.7	95.5	30.0	104.6	80.9	77.3	84.7
Avg.	$290.5	$93.4	32.1	$ 98.6	$84.1	85.3	90.0

The Renegotiation Act permits certain exemptions from renegotiation. C-H, however, does not claim any exemptions. C-H's Controller told us that since C-H has never been in danger of having to make any refund, it is not worth the time and cost to substantiate any exemptions.

SCOPE

We traced elements of the Cutler-Hammer, Inc., cost estimates to source documents (invoices, expense vouchers, etc.) whenever available. For estimates based on employee recollections of time spent on various activities, we interviewed knowledgeable personnel and, to the extent practical, identified the work produced. We also discussed the cost estimates and proposed renegotiation legislation with C-H officials.

Cost estimates prepared by C-H's AIL Division, New York, which generates about 90 percent of C-H's renegotiable business were separately reviewed.

PROCESSING AND REPORTING RENEGOTIATION DATA

The number of Standard Form of Contractor's Report for Renegotiation (RB Form 1) C-H files differs from year to year depending on the organizational composition of C-H, its divisions and subsidiaries. In 1975, for example, C-H prepared nine reports--an overall consolidated report for C-H, Inc., and its subsidiaries; three reports covering C-H, Inc., and each of its two divisions; and five reports covering each of five subsidiary companies.

According to information provided by C-H, processing data for renegotiation reports is time consuming and requires professional skills. The information for the report and schedules is drawn from 17 separate accounting systems. The accounting and financial management systems are designed to produce data in a form useful for managing C-H's business, not to report renegotiation data. Furthermore, none of the systems, including those maintained by the various divisions and subsidiaries, include all of the information necessary for preparing renegotiation reports. As a result, renegotiation data must be abstracted from the system, analyzed, and reclassified by professional accountants.

Developing data for renegotiation starts with coding of sales orders and sales entries relating to renegotiation. If the nature of the sale is not obvious, sales personnel ask the customer if the sale is renegotiable. Some of the coded sales data is stored in the C-H automatic data system and an itemized list of the sales is run to prepare the renegotiation report. Other renegotiation sales data is obtained from each division.

A C-H corporate tax service accountant analyzes sales and cost data and prepares the renegotiation report. The accountant uses Federal income tax worksheets to determine total sales and costs. He determines a portion of renegotiable sales from the listing prepared by the C-H automatic data processing unit and data provided by the various divisions. Renegotiable costs and other income are determined by analysis of the income tax worksheet or by proration in the proportion of renegotiable sales to non-renegotiable sales or some similar method.

The Controller told us that renegotiation comprises a small portion of the duties of personnel involved in the renegotiation process. Thus, he said it is unlikely that C-H would dismiss the individuals if renegotiation were eliminated. Nevertheless, he said that the elimination would result in real savings to C-H. He stated further that somewhere down the line a reduction in work requirements must result in reduced personnel or, the personnel would be shifted to other duties more beneficial to the company. Subsequently, in commenting on our report, the Controller of C-H stated that the staff at both AIL and headquarters would be reduced if renegotiation were not in effect, and that the company estimates a reduction of two professional staff members with a related cost saving of about $36,000 annually.

COST OF RENEGOTIATION

The C-H accounting system does not identify the cost of compliance with renegotiation requirements. Therefore, C-H had to estimate the costs involved. C-H estimated its cost of renegotiation to be $81,379--$66,056 for the AIL Division and $15,323 for C-H headquarters. The headquarters' estimated costs include $4,860 for preparing required annual renegotiation reports and $10,463 for complying with Renegotiation Board requests for information regarding the assigned year, 1972.

The $4,860 estimated cost of preparing required annual reports is a recurring cost. The $10,463 estimate for complying with Board requests, however, may vary from year to year.

C-H officials stated that their cost estimate is a little low. For example, fringe benefits of 25 percent of wages are based on companywide rates; however, fringe benefits for headquarters personnel are higher--possibly as much as 30 percent of wages. Also, the costs do not include nonpersonnel costs and other incidental costs which could be associated with renegotiation.

C-H officials also told us that the Board's requests regarding the FY 1972 reports were so complex that C-H had to hire a consultant at fees of about $30,000 to assist them in responding. Other costs have been incurred to prepare the responses and for travel and consultation. The Board has requested information of similar complexity regarding C-H's FY 1973 reports. C-H has also been assigned for fiscal 1974, but has not received any requests for additional information. C-H has not yet been assigned for fiscal 1975. C-H officials said other costs may decrease since there is a learning process involved and the consultant may not be needed as extensively. They could not, however, predict what the costs would be.

Details of the C-H estimate of its headquarters cost are shown below:

Annual cost of preparing renegotiation reports

Coding, clerical, and computer costs	$ 1,020
Worksheet and report preparation	2,625
Consultation and review	1,215
Total	$ 4,860

Cost of compliance--assigned year 1972

Responses to Renegotiation Board accounting agenda (requests for information)	$ 6,825
Coordinating information--meetings with AIL Division (includes travel and per diem expenses)	3,090
Consultation (outside consultant)	548
Total	$10,463
Total cost of compliance	$15,323

The estimated costs for the various functions--except travel and per diem costs and consultant fees--were based on employees' estimates of the number of days spent on the functions. The estimated days were multiplied by the daily pay rates and average fringe benefits paid companywide. We determined the basis for the pay rate and fringe benefits and found them to be reasonably accurate. We could not verify the time estimates.

Each of the cost estimate elements is described below:

Coding, clerical, and computer costs - $1,020

This cost consists of $900 for 12 days (at $75 a day), which five C-H locations estimated were required to code and accumulate renegotiable data, and $120 for the C-H automatic data processing unit to prepare a listing of renegotiable sales orders.

Worksheet and report preparation - $2,625

This cost was supported by a detailed estimate of the time required for a C-H corporate tax service accountant to prepare worksheets, supporting schedules and the renegotiation reports--35 days at $75 a day.

Consultation and review - $1,215

This function includes $375 for the corporate tax service accountant (5 days at $75 per day); $600 for the corporate tax service manager (5 days at $120 per day); and $240 for the C-H Controller (1 day at $240 per day).

Responses to Renegotiation Board agenda - $6,825

Costs include $825 for 11 days work performed by an accountant and locations other than headquarters; $3,600 for 30 days by the tax service manager; and $2,400 for 10 days by the Controller.

Coordinating information - $3,090

Costs were traced to travel vouchers submitted by the Controller and corporate tax service manager.

Consultation - $548

Costs were traced to bills submitted by an outside consultant. The bills did not show the subject of consultation; the controller stated that the firm is retained solely for advice on renegotiation. The Controller also stated that the AIL Division paid the consultant $29,556.

CONCLUSIONS

Because the C-H estimate of headquarters compliance cost was based largely on employee recollection, we could not verify its accuracy. It was evident that preparation of the renegotiation reports and responses to Renegotiation Board requests required considerable professional accounting skills.

AIL DIVISION

BACKGROUND

AIL is a division of Cutler-Hammer, Inc. (C-H) AIL's renegotiable business constitutes the bulk of Cutler-Hammer's total renegotiable business. The company files an RB Form 1 (Standard Form of Contractor's Report for Renegotiation) on an overall basis, and also files an RB-1 for its AIL Division. We were advised that renegotiation compliance costs are incurred at the AIL Division level and also at the C-H corporate level.

SCOPE

Our review at the AIL Division included discussion of the contractor's support and rationale for the cost data prepared, review of the procedures for preparing the annual renegotiation report (RB-1 form), and a test of data in support of the costs.

COSTS OF COMPLIANCE

AIL's costs to comply with the renegotiation requirements were estimated at about $66,000 yearly. This consists of about $18,500 incurred in preparing the RB-1 report and an additional $47,556 resulting from the Board's assignment process.

C-H's annual report shows that its renegotiation matters were settled for 1971 and prior years without any determination of excessive profit. The contractor's representatives said that in March 1974, the firm's 1972 results were assigned by the Board. According to these representatives the contractor has not been notified of the Board's determination and, indeed, the Board has not completed its review. Thus, the costs attributed to the assignment process may increase before completion.

AIL's estimated costs of compliance are set out in a schedule below. The costs shown are related only to those costs incurred in the preparation of data at the AIL level. As discussed previously, additional costs are incurred at C-H's corporate level in connection with AIL's RB-1.

AIL Division, Cutler-Hammer, Inc.

Annual costs for complying with renegotiation requirements

Preparation of RB-1 report	Amount
Analysis of contract terms, renegotiability, preparation of data for entry into accounting system	$ 2,000
Review of year-end results, analysis and summary of data to compile RB-1 report, review, validation of initially prepared data	5,000
Development of RB-1 data for three other AIL subsidiary companies/divisions	6,500
Consolidation of total AIL results, intercompany eliminations	4,000
Final management review and submission to Cutler-Hammer	1,000
Total	$18,500

Cost of Board's assignment	Amount
Preparation of schedule of major (over $100,000) renegotiable contracts	$ 4,000
Development and preparation of data in response to Board's inquiries and accounting agenda	9,000
Meetings and coordination with Cutler-Hammer headquarters	3,000
Training of personnel--attendance at seminars	1,000
Consultant's costs	29,556
Briefings and top management reviews--AIL Division	1,000
Total	$47,556
Grand Total	$66,056

We noted that AIL's RB-1 report was supported by a file of worksheets and supporting materials. We also observed a mass of material, supporting worksheets and data which was prepared in response to the Board's assignment of the 1972 results. Our observation of these materials and discussions with contractor representatives indicate that substantial effort was involved in complying with the renegotiation requirements.

We were informed that the employees who are involved in the renegotiation process spend only part of their time on these tasks during the year. To this extent they are relieved of other duties. If the Renegotiation Act expired, duties would be rearranged and one position might be eliminated in this division.

USE OF OTHER DATA FOR RENEGOTIATION REPORTING PURPOSES

We were advised that other existing government contract reporting requirements cannot be used, as such, to prepare all required renegotiation information. For example, all contracts received by AIL were not rated under the Defense Production Act priority rating system. Therefore, it is necessary to make further inquiries on the renegotiability status of the order. In addition, the RB-1 Form requires the data to be tied into the firm's financial statements and Federal income tax return. These data include information not generated for government contract purposes.

CONCLUSIONS

Based on our review we believe that:

--The contractor's estimated costs represent incremental costs applicable to the renegotiation requirements. We did not note any costs which were truly discretionary and not required as a result of the renegotiation requirements.

--The costs generally were documented and supported and represent a realistic evaluation of the costs incurred except that the costs of personnel time spent on renegotiation matters were not susceptible to audit verification.

CUTLER • HAMMER

MILWAUKEE, WISCONSIN

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August 29, 1977

Mr. Sidney Wolin
Assistant Director PSAD/GP
U.S. General Accounting Office
441 G Street N.W., Room 6073
Washington, D.C. 20548

Dear Mr. Wolin:

The General Accounting Office, at the request of Senator Proxmire, has recently reviewed Cutler-Hammer's estimated cost of compliance with the Renegotiation Act of 1951. The reviews were conducted in two locations; the AIL Division located in Deer Park, New York, and the Headquarters Office in Milwaukee, Wisconsin. Two separate reports were submitted to you covering these locations, which show the compliance cost of Cutler-Hammer, Inc. to be as follows:

Headquarters Office (From Chicago Region Office Report)	$15,323
AIL Division (From New York Regional Office Report)	66,056
	$81,379

The cost includes $23,360 associated with the preparation of the annual RB-1 Report and $58,019 relating to requests for additional detailed information as a result of the Board's review of the RB-1 Report for 1972. This is the earliest open year currently in process and final resolution has not yet been received from the Board. Additional information may be requested and additional costs incurred before finalization.

We would like to make the following additional comments regarding the reports.

We do not maintain time records with respect to the professional staff that prepares the Renegotiation Report. As a result, the time estimates provided Government representatives were based on studies made by knowledgeable individuals involved in the various aspects of the report preparation. At both the AIL Division and the Headquarters Office, the work papers and files were reviewed and discussed with the examiners. The Company believes that the Government representatives, after reviewing the detailed effort required to comply with requests for information from the Renegotiation Board including the preparation of the recently revised RB-1 Form, were satisfied as to the reasonableness of the estimates resulting from the studies.

The reports also touch on the possible cost savings that would result if the Company did not have to go through the Renegotiation exercise. While it is difficult to be specific in this area, there is no doubt that if the Renegotiation Report were not required, the staff at both AIL and Headquarters would be reduced. Any reduction in work load ultimately has an impinging effect on the number of people required to perform necessary functions. Our best estimate at this point would be a staff reduction of two persons at the bottom of the professional scale as the various time savings kaleidoscoped into a need for fewer staff members. At an estimated cost of $18,000 per staff person (including fringe benefits), this would represent a cost saving of about $36,000 annually.

With respect to the standard commercial article exemption, Cutler-Hammer, Inc. does not claim this exemption because the additional effort required to substantiate the exemptions would be uneconomical. The Company's posture with respect to renegotiation has had no bearing on this decision.

The Federal Income Tax papers do not provide the detail necessary for the Renegotiation Report. They are used to extract detailed information concerning other income, other deductions and book to tax reconciling items in order to allocate these items to renegotiable and non-renegotiable business, since the Renegotiation Report must be prepared on a tax basis. Renegotiable sales and costs must be obtained from the records generated by the accounting systems of the Company.

With respect to the possibility of using a completed contract method of accounting for renegotiation purposes, we indicated that we could not know what problems would be created until rules and regulations as to implementation would be issued. We feel that the completed contract method could create serious cutoff problems with respect to both sales and costs, particularly in the area of amendments and additions to contracts. Of particular concern would be the handling of items normally considered period costs such as G and A expenses. Each contract would have to bear its fair share of such costs for its entire existence as opposed to only a share for the year of completion. Much more information would be needed in this area before the Company could adequately respond regarding its ability to meet the requirements of this type of reporting.

We wish to express our appreciation for the opportunity to review and to comment on the reports. We will be pleased to furnish additional information should further clarification be required.

Very truly yours,

CUTLER-HAMMER, INC.

M. J. Saunders

M. J. Saunders
Controller

MJS/bjh

CC: Mr. A. L. Panico
Mr. J. Sobota

EATON CORPORATION

BACKGROUND

Eaton Corporation, Cleveland, Ohio, is a large diversified manufacturing concern composed of 74 divisions. Its major products are truck and off-highway vehicle components, automotive components, industrial vehicles, construction and woodland vehicles, industrial power transmission systems and components, and security products and systems. Net sales for the fiscal year ended December 31, 1975, were $1.6 billion. Total fiscal 1975 sales subject to the Renegotiation Act were $4.6 million--10 percent exemptions were claimed on these sales. Such sales were attributable to 21 divisions.

Eaton has few direct sales to the Government. Its products are primarily purchased by other manufacturers who use them as components in their products. Some of these products are sold to the Government resulting in an indirect Government sale by Eaton. The Eaton products involved in these indirect sales and those sold commercially are essentially the same.

PROCEDURES FOR COMPLIANCE

Because renegotiable sales are primarily indirect in nature, and not available within their record system, Eaton has chosen to canvas its customers annually to determine the amount of renegotiable sales. Each year Eaton's domestic divisions review their sales records to determine which customers should be sent form letters regarding renegotiable sales. The divisions send out the letters, follow up on those who do not reply, receive and categorize the responses, summarize the data and submit it to the headquarters office.

The headquarters' staff assembles the data submitted by the divisions and prepares and submits the Report for Renegotiation (RB Form 1). Headquarters also fills requests for additional data, providing specific information concerning exemptions, cost allocations, etc. Such requests are received annually from the Eastern Regional Renegotiation Board which generally is assigned Eaton's report. The last time Eaton was determined to have made excess profits was 1958.

COSTS OF COMPLIANCE

Eaton's procedures to comply with Renegotiation Board requirements have been consistently applied for several years. While Eaton does not assemble the associated costs of compliance, we were able to develop estimates of the costs involved.

These estimated costs are (1) solely applicable to the renegotiation function, (2) recurring but probably in differing amounts annually based on the volume of renegotiable sales, and (3) generally would not be considered incremental. Eaton does not compile the costs for complying with Renegotiation Board requirements. Based on data furnished by the contractor, we estimated the total costs for the fiscal 1975 submission to be $18,220. A breakdown follows:

Division costs	$14,710
Headquarters cost	3,510
Total cost	$18,220

Half of the headquarters costs is attributable to responding to the additional data requests from the regional Renegotiation Board. The above estimates are not directly supported by company records. They are based primarily on labor hour estimates provided by Eaton's divisions and headquarters. To the labor hours, we applied hourly labor rates, fringe benefits, and administrative overhead. The hourly labor rates are based on figures developed by Eaton during a study they undertook to evaluate the cost of the proposed product line reporting requirement of the Federal Trade Commission (FTC). The factors for fringe benefits and administrative overhead were also developed during the FTC study and are supported by Eaton's financial records. The methodology used was concurred in by Eaton officials.

Division costs

Total estimated costs incurred by the divisions to develop the fiscal 1975 data were $14,710. These costs are based on time estimates obtained from division personnel responsible for developing the sales data in accordance with the procedures previously described and the estimated number of letters mailed to solicit sales data from customers.

TOTAL DIVISION COST

Divisions with renegotiable sales	740 hours	
Divisions without renegotiable sales	448 hours	
Total hours	1,188 hours	
Hourly labor rate	$8	
Total direct labor cost		$9,504
Fringe benefits--17 percent of labor costs		1,616
Overhead--25 percent of labor and fringe benefits		2,780
Mailing costs-17 cents a letter		810
Total cost		$14,710

To determine the validity of the time estimates underlying these costs, we visited two of the reporting divisions. We interviewed the responsible division officials and reviewed and discussed their annual data-gathering procedure. We also examined the summary schedules prepared by the divisions during the data gathering process.

Based on data provided by Eaton, we estimated 4,767 letters were mailed by the divisions to gather renegotiable sales data for the fiscal 1975 report. Eaton estimated a cost of 17 cents for each letter (postage, typing, stationery, use of copying equipment, etc.). Since postage would be 13 cents for each letter, the estimated cost appears reasonable.

Headquarters' costs

It is estimated that headquarters incurred costs of about $3,510 to comply with Renegotiation Board regulations applicable to the fiscal 1975 report. The cost is based on estimated time spent to prepare and submit the report and fulfill the requests for additional data usually made by the regional Renegotiation Board.

TOTAL HEADQUARTERS COST

Initial filing of RB-1	80 hours	
Providing additional data	80 hours	
Total hours	160 hours	
Hourly labor rate	$15	
Total labor cost		$2,400
Fringe benefits--17 percent of labor		408
Overhead-25 percent of labor and fringe benefits		702
Total cost		$3,510

INCREMENTAL COSTS

The time spent on meeting Board requirements makes up a very small portion of many employees' workyear. Eaton officials stated that no one at the division or headquarters level would be laid off if Eaton had no renegotiable sales.

Vice President and Controller

Eaton Corporation
World Headquarters
100 Erieview Plaza
Cleveland, Ohio 44114

August 17, 1977

Honorable William Proxmire
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

At the request of the General Accounting Office, we have just completed a review of the cost to Eaton of compliance with the reporting requirements for renegotiable sales.

Eaton's total sales in 1975 were $1,558,000,000 of which $1,046,000,000 were domestic. Renegotiable sales were less than $5 million. A reasonably prepared conservative cost estimate indicates the reporting cost to be about $18/$20 thousand. While this is not an earth-shaking amount for a company such as Eaton, it is of interest to note that it has been spent each year without benefit to either Eaton or the government.

This cost of past compliance will be increased many fold by the provisions of the proposed bill. The cost of preparing product line data as required by the current proposal is about $26,250 for a typical division. In 1975, 21 plants equating to approximately 10 divisions were involved in renegotiable business. If product line reporting were limited to only the 21 plants involved in renegotiable business, the reporting cost for Eaton would increase from the $18/20,000 currently experienced to about $280,000. If the reporting covered all of Eaton's domestic plants, the cost would be $18/20,000 plus $420,000 for a total of $438,000. The product line reporting cost was developed by a detailed study of a typical division to determine the cost of complying with the F.T.C. Annual Line of Business program. We urge that consideration be given this additional cost burden in determining the reporting requirements. We will be happy to review all of the problem and cost aspects with you or your staff if this would be helpful to you.

I am pleased that the proposed legislation would not require reporting for companies with less than $5 million of renegotiable sales but would like to point out that this relief would not eliminate the cost of determining if we had unknowingly exceeded this threshold amount. This problem could be overcome by a simple provision exempting product shipped in the normal course of business but subsequently used by the purchaser to fulfill his contract obligations. Without such a provision, Eaton could be placed in the position of incurring compliance costs exceeding $400,000 to report renegotiable sales slightly in excess of $5 million. This statement is not an exaggeration. We are prepared to discuss the detailed procedures which create the cost problem. Even after having incurred this cost, we have no reason to believe an auditor would agree with our cost allocations.

As stated earlier, Eaton's renegotiable business in 1975 was less than $5 million and, consequently, would not have required the filing of a report if the proposed legislation had been in effect. We have no reason to believe this will be true in subsequent years.

We would very much like to be a substantial supplier to the military, and believe our entrance into the market would give the government a competitive wedge which could be used to it's advantage. We have been reluctant to do so because of the cost of compliance with the "red tape" involved, and public disclosure of confidential information which would be helpful to our competitors. There is a need to eliminate such barriers so companies like Eaton would feel free to enter into a truly competitive military procurement market.

Yours very truly,
EATON CORPORATION
Frank C Roberts
Frank C. Roberts
Vice President and Controller

cc: ✓Mr. Gary Chupka - U.S. General Acctg. Office
Mr. John L. Carter - U.S. General Acctg. Office

FAIRCHILD INDUSTRIES, INCORPORATED

Fairchild Industries, Inc., had total sales of about $193 million in the year ending December 31, 1975, of which 64 percent were subject to renegotiation. While Fairchild Industries has seven divisions plus one subsidiary, only two, the Space and Electronics Division and the Republic Division, had substantial renegotiable sales. Renegotiable contracts were for the design, fabrication, assembly and repair of aircraft and parts, the Space Shuttle, and electronic communications equipment.

In June 1977, Fairchild Industries testified before the Senate Committee on Banking, Housing and Urban Affairs concerning legislation to extend and amend the Renegotiation Act. Fairchild Industries did not testify regarding the specific costs to comply with the renegotiation process.

We contacted responsible officials at Fairchild Industries to determine whether compliance cost estimates had been developed. Cost estimates were not available and could not be prepared within the time frame of our review.

JOHN FLUKE MANUFACTURING COMPANY, INCORPORATED

BACKGROUND

John Fluke Manufacturing Company, Inc., Mountlake Terrace, Washington, is engaged in the design, development, manufacture, and sale of commercial electronic test and measurement instruments and systems for scientific, educational, industrial, and governmental applications. The company considers itself to be in one line of business, as defined under the U.S. Government Standard Industrial Classification (SIC)--test and measurement instruments. This firm manufactures digital and differential voltmeters, voltage/current calibrators, high voltage power supplies, frequency counters, frequency synthesizers, digital logic testers, digital thermometers, dataloggers, automatic test equipment, and systems components used and sold either individually or in manual or automatic test systems.

Fluke had total consolidated net sales of $49.2 million during its fiscal year ended September 30, 1976, including $9.3 million of renegotiable sales and $4.5 million of renegotiable-type sales exempt as standard commercial articles. All of the company's renegotiable sales for fiscal year (FY) 1976 were made by its Seattle Division which had total net sales of $31.9 million.

The Renegotiation Board assigned Fluke's FY's 1973, 1974, and 1975 filings to the Board's Western Regional Board for field review. Representatives of the Regional Board visited the Fluke Company on March 21 and 22, 1977, and the company has provided additional information on several occasions since the Board's March visit.

Fluke's system for identifying renegotiable sales and for reporting to the Renegotiation Board involves effort by the company's order processing, data processing, and contract operations departments and by its certified public accounting firm.

The company has two order processing employees who code data for automatic processing from about 60 incoming orders per day. As part of this procedure, the employees must analyze each order to determine if it should be classified as renegotiable or nonrenegotiable and code it accordingly. Fluke officials said that it is not always clear whether orders should be classified as renegotiable, so coding employees must spend considerable time searching through the contractual clauses for such evidence. Since about half of the incoming orders are advance orders, Fluke officials said that a third employee must analyze about 30 confirming orders per day for evidence that they should be classified as renegotiable and recode data if necessary. The order processing supervisor subsequently reviews coded data at shipment by comparing coding sheets and order documents with the Automatic Data Processing (ADP) printout of coded data.

Fluke's data processing department prepares a renegotiable sales report which company officials said is used exclusively for preparing the Renegotiation Report (RB Form 1). The sales report segregates renegotiable and nonrenegotiable sales, cost of sales and commissions data for each Fluke model sold. The data file is updated monthly and printed at year end.

Once the data processing renegotiable sales report has been completed, the contract operations manager reconciles this data to Fluke's total sales shown in the financial statements by reviewing all hand-processed orders for renegotiable sales and adding these to the sales shown in the renegotiable sales report. He said that hand processed orders for FY 1976 totaled about $2 million and all of this amount was renegotiable sales. The contract operations manager also determines which model numbers are standard commercial articles that are exempt from renegotiation and prepares the list of these items for attachment to the RB Form 1. Although Fluke has used the standard commercial article exemption, it has not applied for the standard commercial class exemption.

All of Fluke's employees engaged in identifying and report ing renegotiable sales have other duties. A company official told us that no employees would be released if renegotiation requirements were ever eliminated but hiring of additional personnel would be precluded for some time. He said the number of employees has not increased in recent years commensurate with Fluke's rapid growth.

CONTRACTOR'S ESTIMATED COST
OF COMPLIANCE WITH RENEGOTIATION
ACT REQUIREMENTS

Fluke has increased its estimates of the cost to comply with the requirements of the renegotiation program twice since

John Fluke, President, told the House Subcommittee on General Oversight and Renegotiation that his company's annual cost was $12,000. In subsequent testimony before the Senate Committee on Banking, Housing and Urban Affairs, Mr. Fluke said that, after further checking, the cost was really about $20,000. At the start of our review, the company provided us an estimate which included $37,112 of recurring costs and $4,275 of nonrecurring costs. Fluke said that efforts to identify these costs originally resulted from a cursory review of requirements and that the company was not accorded time and did not think a full blown flow-charting timestudy analysis was warranted. Fluke also said that as more thought was given to the concept of determining true costs of complying with the Renegotiation Act, more areas were discovered which formerly had been overlooked.

<u>Recurring costs</u>

John Fluke Manufacturing Company estimates that recurring costs of $37,112 are incurred each year to report to the Renegotiation Board. The company's estimate consists of the following costs.

Order processing:

Analysis and coding of incoming order	5 minutes
Analysis and recoding of confirming order	6 minutes
Audit of coding at shipment	5-15 minutes
Average time per order	20 minutes
Number of orders per day	60
Number of orders per year	15,600
Cost of order processing (5,200 hours at $3.50 per hour)	$18,200

Data processing:	
Computer time	3,100
Program maintenance	5,000
Contract operations manager's time	1,500
Certified public accountant, for preparation of RB Form 1	3,000
Labor related costs, 25 percent of $25,250	6,312
Total recurring costs	$37,112

Nonrecurring costs

The company also estimates it has incurred nonrecurring costs of $4,275 for supporting the Renegotiation Board's regional representatives during their March audit. The company's estimated audit support costs consisted of the following:

Company time devoted to assisting board auditors:

Vice president-treasurer	1 day
Corporate controller	1 day
Seattle controller	1 day
Contract operations manager	10 days

Total labor cost for 13 days	$1,500
Labor-related costs (25 percent of $1,500)	375
Certified public accountant for 5 days	2,400
Total nonrecurring costs	$4,275

ANALYSIS OF FLUKE'S COST ESTIMATE

Order processing

Fluke's estimated order processing cost was not based on actual recorded costs. Fluke has not validated the estimate and a company official said that it would be difficult to validate the added time because every order situation is different.

The time included for analyzing, coding, recording, and auditing coded renegotiation data appeared high compared to the total time used for coding orders. For example, Fluke estimates that two coding employees each code about 30 orders per day or one order every 16 minutes, whereas, Fluke estimates that the time required for analyzing and coding renegotiation data alone requires 5 minutes per order. The employees also must code a great deal of other data from the order documents not related to renegotiation. We reviewed a group of 26 orders with a Fluke official, which had been coded the previous day, to determine the amount of additional time required to analyze and code renegotiation data. We observed that none of the orders would take more than 1 minute to identify and code the renegotiation information. The official agreed that the time for these orders might be 1 minute or less, but that difficult cases are encountered which take longer. We found none of these difficult cases in our sample.

Fluke also estimated the number of orders processed per year, but did not have summary records which would enable us to verify this number. The company did have records showing that 23,766 invoices were issued during FY 1976; however, this does not represent the number of orders received since sometimes several invoices are issued for the same order.

Fluke's estimate indicates that 60 confirming orders per day are analyzed and recoded if necessary. However, a Fluke official told us that only 30 confirming orders are received each day and that a third employee analyzes them and recodes as necessary.

Although we could not determine how much order processing cost Fluke actually incurs as a result of renegotiation requirements, Fluke officials agreed that the added time would be less than the 20 minutes per order estimated. Based on our discussions with company officials and review of a limited number of coded orders, we believe the cost would be closer to the following:

Order processing:		
Analysis and coding of incoming orders	1-2	minutes
Audit of coding at shipment	2-3	minutes
Average time per order	4	minutes
Number of orders per year	15,600	
Analysis and recoding of confirming orders	1-2	minutes
Number of confirming orders per year	7,800	
Cost of order processing (1,235 hours @ $3.50 per hour)		$4,323

A Fluke order processing official told us that order processing times cited in the company's estimated renegotiation compliance costs of $37,112 included more than costs incurred because of renegotiation. The estimated time includes looking for and coding other unique requirements of government business such as contract requirements for inspection. This official agreed that the times shown above are better estimates of effort solely required by renegotiation requirements. At the conclusion of our review, Fluke officials said that they did not concur with the revised coding times, but they did not provide additional evidence to support their views.

<u>Data processing</u>

Fluke's cost estimate of computer and programing time required for compliance with renegotiation requirements was also based on estimated rather than actual recorded data. Fluke does not maintain time records which would allow us to verify the amount of time expended for renegotiation purposes.

We did determine that the cost per hour for computer time was based on FY 1978 budget data rather than the company's actual incurred cost during FY 1976, its most recently completed fiscal fiscal year. Based on FY 1976 actual cost data, the cost should have been $50 per hour rather than $62 per hour. This reduces estimated annual computer costs by $600.

Fluke estimated that 2 hours per month of computer time is required for updating renegotiation report files and 26 hours are required to run the yearend report. The time required to run the year end report appears high, but a Fluke official said that the report last year had to be run four times before it was right. He said that the process will be changed this year. The report will be run quarterly rather than annually to avoid problems encountered last year. This will reduce the time required to run the report to 16 hours for the year end report.

Contract operations

The Fluke contract operations manager's time devoted to renegotiation is also not recorded separately. Therefore, we could not verify this time estimate.

We reviewed worksheets he prepares to identify standard commercial items not subject to renegotiation. He said that about 3 or 4 days of his time are devoted to developing this list of items exempt from renegotiation. He estimates he spends an additional 11 days on other renegotiation report work.

Certified public accountant (CPA)

Fluke estimated that they pay their certified public accountant $60 per hour and that the CPA spends more than 1 week in preparing the Renegotiation Reports (RB Form 1) for Fluke and its subsidiary, Fluke Trendon. Since the CPA's billings to Fluke did not always show the charges separately for preparing the renegotiation report, we asked the CPA how much his bill is for this purpose. He said that he charges Fluke about 40 hours at his billing rate of $65 per hour or $2,600 to prepare the report.

Labor related costs

Fluke's estimated labor-related costs, such as payroll taxes and employees' insurance, were based on labor costs of

$25,250. The Fluke official who prepared the estimate could not recall how he arrived at this labor cost base. We believe Fluke's estimate of the labor base should have been $19,700 which includes order processing costs of $18,200 and contract operations costs of $1,500. This labor cost base does not include data processing cost that already includes labor related costs. Nor does it include the outside CPA costs because labor related costs are not involved. This labor cost base would be $5,823 if our revised estimate of $4,323 for order processing costs were used instead of Fluke's estimate of $18,200.

Costs incurred to support Renegotiation Board representatives

Fluke estimated that $4,275 of cost were incurred to support Regional Renegotiation Board representatives who were auditing company reports assigned by the Renegotiation Board headquarters. Included in this estimate is $2,400 for services of the certified public accountant. Fluke estimated that the CPA spent 5 days on this effort. However, the CPA told us that he actually billed Fluke about $1,000.

GAO revised estimate

Based on our review and as previously discussed, we found some variations regarding the cost elements in Fluke's estimate. It appears that Fluke's estimate may be overstated by approximately $19,733. This is shown below

	Estimated cost of compliance	
	Fluke	GAO
Order processing	$18,200	$4,323
Data processing	8,100	7,500
Contract operations managers time	1,500	1,500
CPA, for preparation of RB Form 1	3,000	2,600
Labor related costs (25 percent of order processing and contract operations managers time)	6,312	1,456
	$37,112	$17,379
Difference		$19,733

Fluke revision of cost estimate at conclusion of our review

At the conclusion of our review, Fluke provided us with another revised estimate of recurring costs to comply with renegotiation requirements; however, we did not have time to extend our review to determine the accuracy of the new estimate. This revised estimate of $20,506 generally was based on the lower estimated costs indicated by our review, even though Fluke did not agree with our estimate of the time to process orders. However, the company added three additional items not considered in the $37,112 estimate.

--Audit at shipment time should have been applied to each shipment invoice rather than each order. As a result, 23,766 invoices are audited at shipment rather than 15,600 orders.

--Orders coding supervisors' time was not previously included for training and supervision of analysis and coding personnel. Fluke said this would add about 10 percent to the order processing time required for identifying renegotiable business.

--No time was included for analysis and coding of about 2,600 orders received by Fluke's parts department.

Fluke said that this latest revised estimate still does not include any allocations for occupancy cost or other supportive indirect costs, or any amount for responses to vendors' inquiries concerning renegotiable business. Fluke said that this estimate also excludes any costs of training, coordination, or verification efforts related to Fluke field officers and the company's subsidiary, Fluke Trendor.

FMC CORPORATION

BACKGROUND

The FMC Corporation, with headquarters in Chicago, Illinois, is a diversified manufacturer of machinery and chemical products. Sales in 1975 totaled $2,020 million, of which $106 million represented renegotiable sales. FMC's defense equipment group which includes four plants, accounted for $98 million, or 92 percent of the renegotiable sales. FMC defense group sales are comprised of armored personnel carriers, designed and manufactured in San Jose, California; naval gun mounts and shipboard missile handling equipment, designed and produced at Minneapolis, Minnesota; and vehicle track shoes, manufactured at Anniston, Alabama. The remaining $8 million, or 8 percent, of the renegotiable sales were made by 55 plants in FMC's commercial divisions. FMC officials stated that, on the average, 15 of the 55 commercial plants have renegotiable sales.

FMC RENEGOTIATION PROCEDURES

FMC has formal procedures for compiling the information needed for the RB Form 1. Between January and April, each of FMC's 4 defense equipment plants and 55 commercial division plants is required to gather renegotiation data. This includes determining which sales are renegotiable, identifying exempt sales, and determining the costs applicable to renegotiable sales. Generally, the plants must schedule out, for individual renegotiable contracts with billings of at least $1 million, such data as contract costs, sales, and description of products sold or work performed. The information gathered at the plants is forwarded to FMC's headquarters where it is consolidated into the corporate RB Form 1 for submittal to the Renegotiation Board.

SUMMARY

FMC officials estimated that annual renegotiation compliance costs are between $923,400 and $1,751,000 and involved the efforts of between 20 to 34 full-time equivalent employees. FMC officials stated the cost will vary depending on the amount of information FMC, through experience, believes it must gather to satisfy the Renegotiation Board's data requirements, including requests for additional data.

We could not verify the accuracy of the estimates because

--the estimates are judgmental and are not based on specific accounting records, studies, or other documentation;

--the costs are part of the overhead pool which is not segmented by renegotiation effort; and

--we were able to contact only a limited number of FMC employees involved in renegotiation matters.

FMC officials said the cost estimates are based on FMC's experience with its 1971 renegotiation submittal which is currently being reviewed by the Renegotiation Board. Also, FMC officials said they had only about 10 days to prepare the estimates, and that with additional time they could have developed better estimates with some supporting documentation.

FMC officials stated that all estimated costs are recurring and are due solely to complying with the Renegotiation Act.

They stated that if there were no Renegotiation Act, the cost of the outside attorney, whose annual cost ranged from $60,000 to $150,000, would be eliminated.

Subsequently, on August 30, 1977, Mr. Robert McLellan, a vice president, wrote us and stated that FMC management would enforce a reduction in force if the workload of complying with renegotiation requirements did not exist. He stated that about 34 full-time equivalent employees were presently involved in meeting renegotiation requirements.

FMC's renegotiation procedures require that each of the company's 4 defense and 55 commercial plants gather more data than is needed for the RB Form 1 submittal. However, FMC officials stated that, through experience, the additional information is needed to verify that the basic data is correct and to respond to the Board when it reviews the RB Form 1 submittal.

FMC's RENEGOTIABLE COST ESTIMATES

In a July 1, 1977, letter to Senator William Proxmire, an FMC official estimated that FMC would save $1,715,000 annually if the existing requirements for renegotiation were eliminated. The estimate included the cost of (1) preparing the RB Form 1, (2) gathering data for the RB Form 2, including the minimum data which FMC believes is needed for the Statement of Factors, and (3) responding to various questions from the Renegotiation Board staff. The RB Form 2 is a data submissions generally required when a contractor's filing is assigned for field review.

FMC officials stated that a large portion of the cost involves compiling minimum information on the Statement of Factors. This statement is submitted as additional information for consideration in the Board's processing of assigned renegotiation cases. These factors are (1) the reasonableness of cost and profits, (2) the capital involved, (3) extent of risk assumed, (4) contribution to the defense effort, (5) character of business, and (6) the efficiency of the contractor. FMC officials estimated that the annual renegotiation cost would decrease about 46 percent, from $1,715,000 to $923,400, if the minimum data for the Statement of Factors was not gathered. FMC officials could not provide us with an estimate of the cost for just gathering the information needed for the RB Form 1.

The following table shows FMC's estimated renegotiation costs under the existing renegotiation requirement with and without the Statement of Factors data, as well as the number of full-time equivalent employees involved in gathering data for the Renegotiation Board.

	Cost with the Statement of Factors		Cost without the Statement of Factors	
	Full-time equivalent employees	Total cost	Full-time equivalent employees	Total cost
Corporate headquarters and defense operations				
Staff directly involved in renegotiation	4.8	$ 262,000	1.3	$ 76,000
Supporting staff	13.92	624,000	3.77	178,400
Outside attorney	.5	150,000	.2	60,000
Top management	.48	96,000	.13	26,000
Total corporate and defense operations	19.70	$1,132,000	5.40	$340,400
Commercial operations				
Plants with renegotiable sales (15 plants)	6.25	$ 250,000	6.25	$250,000
Plants without renegotiable sales (40 plants)	8.33	333,000	8.33	333,000
Total commercial operations	14.58	583,000	14.58	583,000
Total FMC cost	34.28	$1,715,000	19.98	$923,400

BASIS FOR COST ESTIMATE

FMC officials stated the cost estimates are judgmental and are based on FMC's current experience with its 1971 submittal which is being reviewed by the Renegotiation Board. The officials said FMC expects to continue to make profits, consequently, the cost estimates are based on being involved in proceedings before the Board each year. FMC officials said, based on their experience, they do not expect to receive a clearance from the Board simply on RB Form 1 submittals, therefore, data has to be accumulated in anticipation of being assigned for field review and the Board's request for additional information. They stated that FMC's fiscal years 1972 and 1973 RB Form 1 submittals have been assigned for field review by the Board.

FMC cost estimates include salaries and other expenses for full-time equivalent employees.

Full-time equivalent employees

FMC officials said that the number of full-time equivalent employees represents the efforts of many people throughout the company. The officials could not provide us with a firm estimate of the number of employees involved. They did say that at least 10 employees at each of the 4 defense and 55 commercial plants contribute to gathering renegotiation data. They stated these employees, which are for the most part managerial and professional, include cost accountants, staff accountants, property accountants, purchasing and sales personnel, and material managers as well as supervisory and clerical personnel.

The number of full-time equivalent employees is an estimate by FMC officials of the people involved in renegotiation. In arriving at the number of supporting staff, FMC officials assumed that the requests for information from one equivalent employee directly involved in renegotiation will directly and indirectly, through a "ripple effect," interrupt the work of others equivalent to 80 percent of one supervisor's time, plus 100 percent of the time of 2.1 other employees.

Salaries

FMC's estimated annual salaries for employees engaged in renegotiation matters ranged from $15,000 for some supporting staff to $100,000 for top management. According to an FMC official, the salaries of those involved in renegotiation matters at one defense plant are:

Staff accountant	$18,000
Property accountant	16,500
Cost accountant	15,500
Supervisor	22,000

Other expenses

FMC cost estimates include other expenses such as fringe benefits and other payroll added costs, utilities, supplies, travel, telephone, and occupancy costs. The other expenses are estimated to be equal to the salary an employee receives. For example, both the annual salaries and other expenses of the employees in the commercial operations are $20,000 for a total of $40,000 per employee.

FMC officials stated that pricing other expenses at the same rate as employees' salaries is conservative because the overhead rate is as high as 180 percent for some plants. The officials provided us with a document for one plant showing a manufacturing overhead rate in excess of 180 percent.

EVALUATION OF FMC'S COST ESTIMATES

FMC officials could not provide us with supporting documentation to verify the accuracy of the cost estimates. No specific accounting records or other documents were maintained identifying the names of employees and the time they spent on renegotiation matters. As a result, we could not verify the number, salaries, and other expenses of the FMC employees involved in renegotiation matters. However, we did try to determine how FMC derived (1) the overall cost estimates, (2) the cost associated with the commercial plants, and (3) the amount of employee effort involved in renegotiation matters.

Derivation of FMC's cost estimates

An FMC official said that the cost estimates were prepared by a staff employee at FMC's San Jose Ordnance Plant. However, the staff employee was on vacation during our review and was not available to discuss how he arrived at the cost estimates. His supervisor stated that the estimates were primarily based on discussions between FMC headquarters' staff in Chicago, and staff in FMC's defense equipment group in San Jose. The supervisor said the estimates were essentially an estimate of employees' time spent on renegotiation matters. The supervisor said little canvassing of the various plants was made to get cost estimates from the employees involved in renegotiation.

Commercial plants' renegotiation cost

We questioned FMC officials as to why the 55 commercial plants with only 8 percent of FMC's renegotiable sales have a total cost of $583,000. We were told that all commercial plants submit RB Form 1 data and other data required by FMC's renegotiation procedures. This includes requesting information from all companies who have purchased products from the plants to determine if the products were used in renegotiable contracts. Also the plants must respond to their suppliers on whether the suppliers' products were used in FMC renegotiable contracts. FMC officials said all this takes a considerable amount of time.

We asked FMC officials for the names of employees at three or four commercial plants to contact about their renegotiation costs. We were told the costs are spread over more than one department, such as accounting, purchasing, sales, and material and that there would not be any one person at a plant who could make an accurate estimate of the cost. We were also told that because each plant is operated differently, no two plants would have the same types of costs. FMC officials later allowed us to talk to employees of one commercial plant.

We asked FMC officials for the workpapers supporting the cost estimates for the commercial plants. We were told there were no supporting documents since records of such work are not kept in the normal course of business.

We asked for copies of the sales and purchase order forms used by the commercial plants to determine the effort involved in separating renegotiable sales from nonrenegotiable sales. We were told that each plant is responsible for preparing their own sales orders and that there is little commonality between plants.

Employee effort and cost

In an attempt to determine the employee effort involved in renegotiation matters, we interviewed employees from FMC's headquarters office and one defense and one commercial plant. We also interviewed FMC's outside attorney. A senior accountant from FMC's headquarters stated he spends between 40 to 75 percent of his time on renegotiation matters. The senior accountant said he is responsible for consolidating the renegotiation information from the various defense and commercial plants into the RB Form 1. The senior accountant's time estimate agreed with the time estimate FMC officials had provided us and which they used in developing their overall cost estimate.

Officials from an FMC commercial plant with renegotiable sales stated that the time to assemble and doublecheck the renegotiation data sent to FMC's headquarters is about 3 staff months. This, for the most part, represents management time. The official also stated that an additional 3 staff months is spent on renegotiation matters, such as responding to queries from FMC headquarters and queries from other contractors wanting to know if their sales to FMC were renegotiable. The time involved agreed with the FMC cost estimates.

An official at one defense plant stated that the employees involved in gathering renegotiation data include cost, staff, and property accountants, as well as secretaries and a manager. We were told the full-time employee equivalent for preparation of the RB Form 1 is 20 percent of one employee's time. This estimate agrees with the estimates FMC officials had provided us.

FMC cost estimates for an outside attorney range from $60,000 for time spent primarily on the RB Form 1 submittal to $150,000 for also preparing the Statement of Factors. FMC officials showed us the attorney's charges of $60,000 for a 9-month period. FMC officials said the charges included all the attorney's time and most of his expenses and were for services which included preparing the Statement of Factors for FMC's 1971 RB Form 1 submittal. We pointed out the discrepancy between the $60,000 attorney charges for 9 months and the estimated $150,000 cost for 12 months. FMC officials said the attorney's level-of-effort varies considerably, depending on the demands from the Renegotiation Board. They said the attorney's billing for the most recent month was about $12,000.

We asked FMC officials and FMC's outside attorney why an outside attorney was needed for the preparation of the RB Form 1. We were told that an expert in renegotiation is needed because the reporting requirements of the Renegotiation Act are very complicated, especially in regard to the applicability of exemptions, reconciliation of the information on the RB Form 1 to the tax returns, and determination of appropriate cost allocation methods.

FMC's renegotiation procedures

We analyzed FMC's renegotiation procedures and found that about 35 percent of the data collected at each plant is needed to complete the RB Form 1. FMC officials said the remaining 65 percent of the data can be used for the RB Form 2 and other renegotiation related information the Board may request. According to FMC officials, experience has shown that all the data must be collected in anticipation that the RB Form 1 submittal will be reviewed by the Board.

CONCLUSIONS

Because FMC did not maintain records on the cost associated with renegotiation matters, we could not verify the accuracy or reasonableness of any of FMC's cost estimate.

The FMC employee who made the estimates was not available to discuss with us how the estimates were derived. Also the few FMC employees we interviewed did not give us specific details of their costs or the effort involved in gathering renegotiation data.

Time did not permit us to interview employees or examine renegotiation procedures at any of the 40 commercial plants without renegotiable sales. Therefore, we could not determine the reasonableness of the $333,000 estimated cost of gathering renegotiation data at these plants. The process of determining whether sales are renegotiable may or may not be this costly.

The magnitude of FMC's cost estimates and the amount of renegotiation data collected rests on the assumption that the Board will request supplemental data on each RB Form 1 submittal. This may be a valid assumption because FMC's 1971, 1972, and 1973 submittals have been assigned by the Board for field review. Consequently, it may be reasonable for FMC to collect additional data in anticipation of the Board's requests. However, a major portion of FMC's estimate ($791,600 of the $1,715,000 under the existing Renegotiation Act) is for preparing data for the Statement of Factors. FMC officials said that data for a new Statement of Factors must be accumulated each year. However, in our opinion, it is possible that once FMC obtains data for 1 year's

Statement of Factors, which is currently being done for FMC's 1971 submittal, subsequent submittals will consist of just updating the prior year's Statement of Factors. Therefore, FMC's cost could be lower than presently estimated.

August 30, 1977

The Honorable Elmer B. Staats
Controller General of the United States
U.S. General Accounting Office
441 G Street N.W.
Washington, D.C. 20548

Dear General Staats:

On August 19, 1977 the GAO San Francisco Regional Office forwarded to you a review of FMC Corporation's estimates of cost to comply with current Renegotiation Act requirements as well as estimates of costs that would be involved to comply with requirements if pending legislation (H.R.5959 and S.1594) were enacted. The purpose of this letter is to record our strong disagreement with the conclusion stated in that review.

The conclusion of the review states that "in our opinion, FMC does experience cost in complying with the Renegotiation Act." It goes on to state, however, that "the only cost which would be eliminated if there were no renegotiation requirements is the $60,000 to $150,000 FMC officials estimate it is spending on an outside attorney." The contradiction between recognizing that FMC has additional costs, but that the only savings would be the cost of an outside attorney, apparently results from the deduction that FMC management would take no action to make a reduction in force of the number of people equivalent to those now required to meet renegotiation requirements. It is possible that the reviewers were led to this erroneous conclusion through their discussions with various FMC accounting personnel and perhaps because we don't have a distinct department to account for the cost of renegotiation. It should be clearly understood, however, that FMC management would enforce a reduction in force if the workload of complying with renegotiation requirements did not exist. As you will have noted from the GAO review, we estimate that a total of 34.28 full-time equivalent employees are presently involved in meeting renegotiation requirements. (See GAO note below).

I would emphasize that FMC in testimony before the Senate

GAO NOTE:

The statements in our draft report referred to in this paragraph have been revised in this final report. The statements were based on comments of contractor personnel obtained during our review. The final report reflects the position of FMC management that a reduction in force would be made.

Banking Committee and subsequently in my letter of July 1 to Senator Proxmire made clear that the costs we now experience in complying with renegotiation requirements can only be expressed as estimates and it was our agreement with Senator Proxmire that GAO examine these figures on the bases that they are estimates. We have not in any way suggested that we keep accounting records to separate renegotiation costs. The review necessarily, therefore, could address itself only to an examination of estimates.

It should especially be recognized that the additional cost to meet the requirements of proposed legislation can only be an estimate. It is obvious, therefore, that no historical documentation exists. Beyond the present requirement of 34.28 full-time equivalent employees to meet current renegotiation matters, it is our estimate that there would be an additional 42 full-time equivalent employees required to meet the requirements of pending legislation.

If the reviewers agree with the methodology followed to develop our estimates, it follows that they must essentially agree with the estimates. If they agree with the estimates (or at least approximately so), they cannot reasonably conclude that the only cost to be eliminated is that of an outside attorney. Rather, it can only logically be concluded that our renegotiation costs as estimated would be eliminated if there was in fact no renegotiation requirement.

We would appreciate it if a copy of this letter could be made a part of any statements GAO may make on this matter or any distribution of the review report.

Sincerely yours,

Robert McLellan

vz

cc: Mr. Richard Guttman
U.S. General Accounting Office

HEWLETT-PACKARD COMPANY

In testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs in June 1977, David Packard, Chairman of the Hewlett-Packard Company (HP) stated it cost his company between $160,000 and $180,000 each year to deal with renegotiation matters. To support these costs, Hewlett-Packard staff provided GAO with the following statement of renegotiation costs for calendar year 1976.

	Cited by H-P	Examined by GAO
Order processing costs	$ 77,000	$ 70,000
Renegotiation report preparation costs	82,000	82,000
Additional requested information costs	20,000	20,000
Data processing costs	9,000	9,000
Other renegotiation-related costs	10,000	-
Total	a/$198,000	b/$181,000

a/ Rounded. Also, Hewlett-Packard Company's cost schedule contained two estimates for order coding costs which differ by $49,500. The larger amount would increase the total cost estimate to $247,000.

b/ Rounded

The above costs include those associated with preparation of the contractor's 1975 renegotiation filing and accumulation of data for the 1976 filing, as well as costs incurred to provide the Renegotiation Board with additional information relating to the contractor's 1972 filing which was assigned by the Washington Renegotiation Board to its Western Region for review for possible excess profits.

To evaluate the validity of the costs cited to comply with the renegotiation requirements, we examined the basis and support for $181,000 (91 percent) of the cost specified on Hewlett-Packard Company's statement of costs. In summary we found that: (1) most of the costs are based on estimates of staff time expended on various renegotiation matters which cannot be readily validated due to an absence of formal documentation and records of actual staff time charged to renegotiations; (2) documentation is available in the form of correspondence and worksheets which indicate a considerable effort was expended on renegotiation matters by the contractor's staff and that in this context there are costs involved; and (3) about $147,000 of the $181,000 relate to activities which are recurring, the remainder were related to nonrecurring activities.

Generally, we were unable to identify the incremental cost associated with these recurring activities because most of the Hewlett-Packard Company staff involved in renegotiation devote a relatively minor portion of their total time to this activity.

The following chart is a breakout of the $181,000 we examined, classified into the major areas of renegotiation effort:

Annual renegotiation filing	$139,000
Annual standard commercial article and class exemption	8,000
Annual new durable productive equipment exemption	5,000
Development of new series of renegotiation computer programs	14,000
Additional information provided board regarding 1972 filing	15,000
Total	a/$181,000

a/ Costs cited were rounded to nearest $1,000.

BACKGROUND ON HEWLETT-PACKARD COMPANY

Hewlett-Packard Company is a major designer and manufacturer of precision electronic equipment for measurement, analysis, and computation. The company manufactures more than 3,500 different products in approximately 30 product divisions. Each division is organized to function like a separate business with its own set of products, research and development laboratories, manufacturing facilities, and marketing and administrative staffs. Product divisions are organized into six major product groups:

(1) electronic test and measuring instruments and systems, (2) computers and computer-based systems, (3) calculators, (4) solid-state components, (5) medical electronic products, and (6) electronic instrumentation for chemical analysis.

Hewlett-Packard's 33,000 employees are spread out among manufacturing plants in 17 locations in the United States and 8 overseas. The company also has 172 sales offices in 65 countries, of which about 70 are in the United States.

In 1976, H-P passed the billion dollar mark in sales for the first time with earnings for the year of $90.8 million. International orders account for about half of H-P's business.

For 1974, H-P reported renegotiable sales of $113 million out of total sales of over $884 million. Hewlett-Packard reduced the actual sales subject to renegotiation to $24 million by claiming $89 million in exemptions. The exemptions claimed consisted of $42 million under the standard commercial article exemption, 1/ $33 million under the standard commercial class exemption, 2/ and $14 million under the new durable productive equipment exemption. The standard commercial product article and class exemptions are not mandatory as they can be waived by the contractor and, therefore, it is the contractor's option

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1/To obtain this exemption, at least 55 percent of the total sales of each product must be nonrenegotiable.

2/To obtain this exemption, at least 55 percent of the total sales of each class of products must be nonrenegotiable.

whether or not to devote additional time developing and supporting these exemptions.

Hewlett-Packard's 1975 renegotiation filing which was submitted to the Renegotiation Board in January 1977 was comparable to the 1974 filings in that it contained approximately the same percentage of renegotiable sales for which exemptions were claimed (79 percent in 1974 and 77 percent in 1975). In 1975, renegotiable sales reported totaled $126 million and exemptions, $97 million.

The Renegotiation Board official told us H-P's renegotiation filing differs from other contractors' filings in the extent to which renegotiable sales are claimed as exemptions. Board officials stated that the percentage of renegotiable sales claimed as exemptions is high and that the total dollar amount is not only high but quite unusual compared to other contractors. The Board reported that in 1974 the exemptions claimed by H-P represented 8 percent of all exemptions claimed under the Renegotiation Act by all contractors in all industries.

Hewlett-Packard cited the 10 following activities as annually performed to prepare the renegotiation reports.

1. The coding of each domestic order as either a renegotiable prime contract sale, a renegotiable subcontract sale, or a nonrenegotiable sale.

2. The annual extraction and summarization of data relating to actual shipments to obtain renegotiable sales.

3. The reconciliation of renegotiation sales data to official accounting records and tax return.

4. The identification and summarization of sales eligible for the standard commercial products class exemption by product class.

5. The identification and summarization of those sales not eligible for the class exemption but eligible for the standard commercial products article exemption by specific product.

6. The review and identification of the sales not eligible for the standard commercial products exemption but possibly eligible for the new durable productive equipment exemption.

7. The summarization of sales by H-P divisions as to renegotiable prime contract, renegotiable subcontract, and nonrenegotiable and the reconciliation by each division to their official accounting and tax records.

8. The calculation of cost of goods sold relating to renegotiable sales which requires the identification and elimination of intra-corporate sales, the reclassification of material, labor, and overhead transfers, the summarization of research and development and manufacturing overhead expenses by major account.

9. The classification of other income and expense items such as marketing by major account.

10. The preparation and filing of the annual renegotiation report and required schedules.

Hewlett-Packard also codes each domestic order as either a government or commercial sale for use in claiming the standard commercial products (catalog) exemption from submission of cost or pricing data under Public Law 87-653 (Truth-in-Negotiations Act). The coding of a sale for compliance with Truth in Negotiations regulations and the Renegotiation Act is performed by the same H-P order-processing clerks, along with other coding tasks as part of the process necessary to input a sale into H-P's computerized records system. However, different codes are used and different computer reports are generated to identify standard commercial products under each of the two laws. This is necessary because not all sales to the Government are renegotiable sales. For example, a sales to the Veterans Administration or Department of Health, Education and Welfare would be considered a Government sale under Truth in negotiations regulations, but as a nonrenegotiable sale under the Renegotiation Act.

ORDER CODING COSTS

Hewlett-Packard cited $77,275 as the cost associated with the identification and coding of individual sales (customer purchase orders) as renegotiable or nonrenegotiable. We examined H-P's support for $70,825 of this cost which consisted of labor and fringe-benefit costs for order processing clerks ($49,500) and supervisory personnel ($12,500), and occupancy costs including the telephone ($8,825).

Hewlett-Packard's government reporting manager, who prepared the cost statement, told us these costs are estimates because H-P staff do not separately record and report the time they spend on renegotiation. He also told us the estimates were not based on time and motion studies on how order processing clerks spend their time. The $49,500 cost estimate for order processing clerks was based on an estimate of 1 minute per order to code a sale for renegotiation. 1/ We were also

1/H-P's statement also contained a $99,000 figure based on 2 minutes per order. H-P's Government Reporting Manager stated different estimates were received over the phone from the company's regional sales order managers.

told the $12,500 supervisory cost was a rough estimate of the minimum annual cost, and it was not based on any specific study, or inquiry, of the time supervisors spend reviewing the work of order-processing clerks regarding renegotiation. The $8,825 cost estimate was based on 1/90 of the total occupancy and telephone cost associated with order processing because 1 of the 90 items on the order coding sheet deals with renegotiation.

Nationwide, H-P has approximately 70 sales offices and the equivalent of about 200 order processing clerks who processed approximately 450,000 orders in calendar year 1976. We visited one large sales office with 13 full-time order processing clerks to ascertain how much time was devoted to renegotiation coding and if any of the clerks' jobs would be eliminated if renegotiation requirements were discontinued.

Our discussions with the sales office manager, two supervisors, and three order processing clerks disclosed that the effort involved in coding an order for renegotiation can vary greatly from a matter of seconds to considerably more time in those instances where it was necessary to follow up with a customer to obtain additional information regarding renegotiation. The sales office personnel we contacted were unable to provide us with an estimate of how much time they devoted to renegotiation coding because it is only one of many matters they dealt with when coding a sales order. The sales office manager further stated that no sales office positions would be eliminated if renegotiation coding requirements were discontinued.

Hewlett-Packard's order-processing clerks examine individual incoming sales and code, on a worksheet for keypunching, whether the sale is subject to renegotiation. At the same time, other information is also entered on the worksheet for input into H-P's computerized records system. Among this other information are the following: (1) whether the sale is a Government or commercial sale under Public Law 87-653; (2) the customer's purchase order number; (3) any government contract number; (4) the priority rating; (5) the required delivery date; (6) whether the sale is taxable; (7) which salesman gets the commission; (8) any applicable discounts; (9) the quantity, product number, and the price for each item ordered; (10) where to deliver; and (11) where to invoice.

To get some idea of the effort involved in coding an order for renegotiation, we examined 36 recent sales, 11 of which were provided by H-P in response to our request for examples where the coding for renegotiation was not routine. For the 25 sales pulled at random by H-P staff from their sales files, we were able to readily ascertain from the information contained on the customer's purchase order whether the sale was subject to renegotiation.

We also had no problem ascertaining whether the sales were renegotiable for the 11 sales which H-P maintained some problem was encountered by the order-processing clerks in coding for renegotiations. We could envision that an order processing clerk may have had a question on how to code the orders, but, in our opinion, the clerk's supervisor should have been able to resolve the question without any followup with the customer.

In the case of six of these 11 orders, sufficient information was available to clearly identify whether the sale was renegotiable. For example, one order was from a University of California activity located at a Veteran's Administration Hospital; a second order was from the Tennessee Valley Authority; and, a third from a customer with an address at Arnold Air Force Station and a Department of Defense Priority rating specified in the order.

Three of the 11 orders involved processing a change order and recoding for renegotiation based on additional information contained in the customer's confirmation (purchase order). However, the additional information also changed the commerciality coding under Public Law 87-653 for all three orders, the Department of Defense priority rating for two of the orders, and the government contract number for one order. Sufficient information was contained in the confirmation to identify the correct renegotiation coding.

Coding the remaining two sales for renegotiation probably involved additional time and judgment on the part of the order processing clerks or their supervisor, but in our opinion, there should not have been any significant problem. Both orders involved possible exclusion from renegotiable sales based on "the under $1,000 and required delivery in less than 30 days" exemption provision. One order from the Energy Research and Development Administration specified the required delivery date as "immediate" which H-P staff claimed presented a problem as to whether the order should be considered as requiring delivery in under 30 days. The second order, from the Air Force, involved an amendment which slightly changed the price discount. Hewlett-Packard staff claimed this presented a problem as to whether the original order date or the amended order date should be used when applying the "under 30-day required delivery date" provision for exclusion.

RENEGOTIATION REPORT
PREPARATION COSTS

The renegotiation costs listed by H-P for calendar year 1976 included $81,620 for renegotiation report preparation costs. We examined H-P's support for the $81,620 and noted that, for the most part, it consisted of estimates of staff time devoted to various renegotiation matters, and that these estimates were not based on records or reports of actual time charges. Since H-P's staff do not record the time they spend on specific jobs of this nature, we were unable to verify the accuracy of the $81,620. H-P staff did show us supporting documentation which consisted of correspondence, memos, schedules, workpapers, travel records, and computer reports with extensive manual notations which indicated a considerable amount of staff time was expended in preparing renegotiation reports.

By reviewing available documentation and from discussions with H-P staff members, we identified the four following renegotiation tasks as those which were included in the $81,620 total:

1.	Preparing the annual renegotiation filing.	$59,281
2.	Applying for the standard commercial article and class exemption.	8,261
3.	Applying for the new durable productive equipment exemption.	5,311
4.	Developing a series of new computer programs.	8,767
	Total	$81,620

The $59,281 associated with preparing the annual renegotiation filing consisted of $42,860, attributed by H-P's staff to the effort involved at the company's various divisions, and $16,421 to the effort at corporate headquarters. For the $42,860, we were told by H-P's government reporting manager that he estimated the salary and fringe-benefit costs a division would expend in responding to his request for information on the division's sales and cost of goods sold. We were shown a January 1976 request sent to the company's 28 domestic divisions which involved completing five schedules. We verified that the divisions completed the schedules. We contacted a cost accounting supervisor at one division who told us the division devoted approximately 12 staff days to complete the schedules, and that the schedules were not needed by the division for any other purpose. H-P also provided us with cost estimates to complete the same schedules in 1977 which were telephoned to the corporate office by six of its divisions. The estimates ranged from $342 to $2,724.

The $16,421 corporate reporting costs consisted of estimates of salary, fringe benefits, travel, and occupancy costs which H-P's government reporting manager told us he arrived at, based on his personal knowledge of what was done during calendar year 1976, and his review of various correspondence, calendar notations, travel vouchers, and workpapers. He also identified the specific staff members involved. We examined various workpapers which contained renegotiation information scheduled and computed on a divisional and consolidated basis. We also confirmed with the Renegotiation Board's Western Region that they expect a contractor to develop renegotiation data on a division basis and to be able to reconcile such data with the contractor's official accounting records and financial statements.

The $8,261 in estimated costs associated with applying for the standard commercial article and class exemptions consisted of salary and fringe benefit costs. H-P's government reporting manager told us he estimated the amount of staff time he and his staff spent on this task in 1976. He showed us the information sent to the Renegotiation Board, workpaper schedules, and a computer listing of sales by division and product number with extensive manual notations and computations relating to standard commercial product class and article exemptions.

According to H-P's government reporting manager, the $5,311 estimated cost of applying for the new durable productive equipment exemption was arrived at by estimating how much time he and his staff devoted to the effort and also the time spent by the various divisions' staff he contacted. He provided us with a four page listing which identified some 22 tasks performed, the names of the division staff contacted and the estimated staff hours involved.

The $8,767 estimated cost relating to developing a series of new computer programs to extract renegotiation information from H-P's computerized records system consisted of salary and fringe-benefit costs. To support their estimate, H-P's government reporting staff showed us correspondence sent to the company's divisions requesting information, informal notes taken at meetings, computer program flow charts developed, and the identification of H-P computer staff contacted. We contacted one of the computer staff members cited who confirmed an effort had been expended developing a new series of computer programs for renegotiation.

ADDITONAL REQUESTED INFORMATION COSTS

Hewlett-Packard cited $19,800 as the cost to comply primarily with the Renegotiation Board's requests for additional information during calendar year 1976. While we were unable to verify the accuracy of this claimed cost, we examined H-P's support and noted that $14,800 was attributed to the effort involved in providing information concerning H-P's 1972 renegotiation filing which was under assignment to the Board's Western Region, and $5,000 was attributed to the time devoted to renegotiation matters by the next level H-P manager above the H-P government reporting manager.

In support of the $14,800, H-P provided us with a three page listing, by month, of the government reporting manager's cost estimate of the staff days and travel devoted to providing the Board with additional information. The listing cited telephone contacts with the Board, visits to the Board, and revised cost and sales information provided the Board. We examined selected travel vouchers, correspondence and detailed workpaper schedules that supported the fact that the Board had requested additional information and that H-P had expended some staff time to develop the information.

Hewlett-Packard's government reporting manager told us the $5,000 attributed to the time his former boss spent on the renegotiation was in addition to this indiviudual's time already included in the above $14,800. He also stated the $5,000 was a rough estimate for which he had no specific support. We contacted the individual involved and were told he was responsible for three H-P departments at the time, one of which was Government reporting. He was unable to provide us with a precise estimate of how much time he devoted to renegotiation matters.

during calendar year 1976, but did state that, in his opinion, the $5,000 figure would not be unreasonable.

DATA PROCESSING COSTS

Hewlett-Packard cited $8,560 as data processing costs associated with its renegotiation efforts in calendar year 1976. We examined H-P's supporting documentation and noted that $4,760 was related to the development and testing of a series of new computer programs, and $3,800 was related to compiling renegotiation sales information for the annual filing with the Renegotiation Board.

In support of the $4,760, H-P showed us computer service billings and correspondence from the company's Corporate Marketing Service. We contacted an official of Corporate Marketing Service and were told that $4,360 was based on the actual hours spent on the new computer programs by two programers and the estimated time spent by a third programer. We were also told the salary rate used for programing was H-P's standard rate charged for such services. An additional $400 was supported by billings for computer time which we were told was used to generate a mid-year trial computer run to ascertain if portions of the existing computer renegotiation sales program would be acceptable for incorporation into the new series of programs under development.

To support the $3,800 computer cost related to compiling the renegotiation sales information for the annual filing, H-P also used the same aforementioned computer service billings and correspondence. From this documentation, H-P staff identified

$1,200 of computer time using the new series of computer programs, and $1,800 of computer time using the prior programs. In addition, H-P's government reporting manager told us $800 was included to cover the computer time incurred by the various H-P divisions for renegotiation purposes.

OTHER RENEGOTIATION RELATED COSTS

An additional $9,920 was cited by H-P as relating to attendance at renegotiation seminars, visits to various company divisions to discuss renegotiation matters, discussions of renegotiation matters at contract managers' meetings, work on formal renegotiation procedures, and a task force's efforts in developing renegotiation and commerciality guidelines for order-processing clerks. Due to the relatively small amount involved and our tight reporting deadline, we did not examine the support for these cited costs.

HEWLETT-PACKARD COMPANY
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ROBERT L. BONIFACE
EXECUTIVE VICE PRESIDENT

August 25, 1977

Mr. Richard W. Gutmann, Director
Procurement & Systems Acquisition Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Gutmann:

We acknowledge the opportunity to read your Workpaper Summary entitled "Review of Renegotiation Act Compliance Costs Cited by Hewlett-Packard Company in Testimony Before Senate Committee on Banking, Housing and Urban Affairs," Code 950422.

We are disappointed that the document does not reflect either of the two major points we made during the exit interview, on which all of our participants believe there was some concurrence by members of your audit team. We here reiterate the points and then their significance in the larger context in which we sought the audit.

1. On pages 6 and 9 in particular you confirm that compliance with the Renegotiation Act requires a substantially different collection and aggregation of data than that required under PL 87-653 (Truth in Negotiations Act). This finding is basic to any assessment of the challenge raised to our testimony before the Senate Committee on Banking, Housing and Urban Affairs in June of this year. As such it must be reflected as a separate item in the summary findings on page 2. Further, Congress needs to know that there is a substantial difference in the reporting requirements of these two acts and that compliance with Truth in Negotiations does not relieve the contractor of the burden of compliance with Renegotiation.

2. Your summary chose to emphasize that our "estimates of staff time expended on various renegotiation matters ...cannot be readily validated...", a point which recurs throughout the Workpaper Summary. Its recurrence, however, is always as a caveat to a finding that some

> effort was expended and apparent acceptance of the fact that the estimates were neither unrealistic nor unreasonable, e.g. "...the effort involved in coding an order for renegotiation can vary greatly from a matter of seconds to considerably more time in those instances where it was necessary to follow up with a customer to obtain additional information regarding renegotiation" (page 8). In each category of costs your Workpaper Summary concurred that staff time was expended. In no category does it assert that the estimates made were unreasonable or unrealistic. If in fact you neither challenge nor validate our estimates, Congress needs to have both sides of that coin in your page 2 summary point.

The report makes a special point "that only one job would be eliminated" if renegotiation was terminated. We question the validity of this criterion as a measure of incremental cost. Renegotiation is a task for a great many people within Hewlett-Packard. If renegotiation is eliminated, tasks would be reassigned -- a normal and everyday function of administration, and on a cumulative basis fewer people would need to be hired as the company continues to grow. During calendar year 1976 it took over 17,700 hours to comply with the requirements of the Renegotiation Act. This cumulative effort (tasks) equates to 8-1/2 people. Looking to the future of the company, this means a maximum of eight fewer people are needed for an expanding work force if renegotiation is eliminated.

We appreciate that you were asked to review our costs. All such reviews have a purpose and a conclusion is sought. Although the report contains a summary statement within the second paragraph on page 2, it does not include a conclusion with regard to whether there is any factual support for the charges made by the Chairman of the Renegotiation Board in his testimony before the Senate Committee. You will recall that the Chairman made two points: (1) the Hewlett-Packard estimate of compliance is "erroneous in every respect" (lines 12 and 13, page 189), and (2) "the records the contractor maintains for Public Law 87-653 are identical to those required for renegotiation," and therefore the contractor "was irresponsible, if not misleading" in submitting testimony to Congress that "the cost of such recordkeeping is attributable to the renegotiation process" (line 21, page 189, through line 2, page 190). Similar statements appear in the testimony beginning at line 16, page 212, through line 10, page 214.

We believe the Senate Committee and Hewlett-Packard are entitled to a direct answer to such charges to the extent that the findings of the audit address these issues. Further, the answer to the charges must be on the public record along with the charges themselves and must have the visibility of inclusion in the summary.

It is our hope that all of the concerned parties in this issue of renegotiation will have benefitted from this audit. We believe it has been helpful in understanding the magnitude of effort required and the extent to which a regulation of this kind can permeate throughout a commercial contractor's organization.

Sincerely,

Robert L. Boniface

Robert L. Boniface

RLB:ac

cc: H. J. D'Ambrogia, GAO, San Francisco
John Young, Exec. V.P, Hewlett-Packard
David Packard

TELEDYNE, INC.

We contacted Mr. Barry Shillito, vice president, Teledyne, Inc., in order to validate the cost of compliance estimate provided during recent Senate Banking Committee hearings. Mr. Shillito advised us that his testimony was not based on company cost estimates. The $20,000 estimate per Renegotiation Board filing was based on personal experience, intuition, and discussions with members of the Financial Executives Institute. In essence, his testimony was based on Financial Executive Institute data presented in House and Senate testimony.

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

The membership of the Aerospace Industries Association of America, Inc. (AIA), is comprised of some 45 corporations, many of which are major Department of Defense and National Aeronautics and Space Administration suppliers. The Association has testified several times concerning the renegotiation process, most recently before the Senate Committee on Banking, Housing and Urban Affairs in June 1977. During these hearings AIA testified that a survey of member companies indicated that costs to industry to comply with the Renegotiation Act were twice as great as amounts recovered by the Renegotiation Board.

We obtained the study upon which the AIA based its estimate that industry costs were double the amount returned to the Treasury. The study was previously supplied to the Joint Committee on Internal Revenue Taxation in September 1975. The study was based on FY 1970-1974 information. The AIA states that as a trade association it does not identify any particular company but only publishes survey figures in the aggregate. Pursuant to such policy, supporting data (i.e., input from member corporations) has been destroyed.

The AIA calculated that the average annual cost to industry during the period 1970-1974 was about $45 million, whereas according to Renegotiation Board reports, and assuming a 50 percent tax rate, the average net return to the U.S. Treasury was approximately $24 million. These figures would support approximately a 2:1 ratio.

The method used by AIA to calculate average annual industry costs is as follows:

Nine of the largest AIA member companies were surveyed. The cost to comply ranged from a high of $225,000 to a low of $50,000. The total company costs were divided by the number of organizational entities in each company and the average annual cost for each organizational entity involved was $5,865. When the very high and very low cost-to-comply estimates were discounted, the AIA survey indicated that a figure of $100,000 for a large company and $5,000 for a small company would be reasonable. The cost for a small company is based on the assumption that it would incur costs similar to an organizational entity of a large company. As noted previously, we did not have access to the data compiled by AIA to verify its accuracy.

The filing companies were stratified by size and the average annual industry cost was determined as shown below. Again, we cannot determine the validity of this stratification due to lack of data; however, the number of filings appears reasonable based on Renegotiation Board estimates.

Number of filings	Percent of total filings	Cost per filing	Total
25	.6	$100,000	$ 2,500,000
50	1.1	75,000	3,750,000
225	5.2	50,000	11,250,000
1,500	34.3	10,000	15,000,000
2,570	58.8	5,000	12,850,000
4,370	100.0		$45,350,000

This results in an average annual cost of about $10,300 per filing.

ENCLOSURE 2

COMPARISON OF CONTRACTOR ESTIMATES WITH RENEGOTIATION BOARD STUDY

COMPARISON OF CONTRACTOR ESTIMATES WITH RENEGOTIATION BOARD STUDY

In March 1977, the Renegotiation Board completed a study for the Office of Management and Budget on industry costs of renegotiation. The study estimated that the average contractor's cost to file was over $3,300. When multiplied by the 3,067 filings received in FY 1976, the projected total cost to industry is over $10 million each year.

We were informed by the Board that its estimated cost represents the cost per individual filing. When a company with a divisional corporate structure files a report, the Board counts this as a single filing. But when a company that has subsidiaries files an RB Form 1 report, each subsidiary must also file a report. These filings are counted as separate filings by the Board. The indicated cost estimates by the Board for the three firms in its analysis are just for the parent companies and do not include the filing cost for any subsidiaries. For example, we were told that the Board's estimate of $325 for Hopeman Brothers discussed below, does not include the filing costs of its four subsidiaries. Further, the $130 estimate for Astrosystems, also discussed below, does not include the filing cost of its subsidiary.

The Renegotiation Board analysis was based on data for three different contractors. These three contractors were selected because the Renegotiation Board believed the contractors' renegotiation costs to be typical of companies with similar sales volume. The three contractors, Astrosystems, Inc., Hopeman Brothers, Inc.; and Martin Marietta had renegotiable sales of about $1.1 million, $10 million and $275 million, respectively. All three cases were assigned to regional boards and costs were estimated for the initial filing and subsequent expenses when an assignment was made. The following table illustrates costs to the contractor.

Cost of Renegotiation

Firm	80 percent Unassigned	20 percent assigned	Total Avg. cost of group	Percent of filing	Average group cost X filing percent
ASTRO Systems ($1-10 million sales volume)	a/$130	$2,080	$520	35	$ 182.00
Hopeman Bros. ($10-50 million sales volume)	b/325	3,575	975	55	536.25
Martin Marietta (Over $50 million sales volume)	16,250	65,000	26,000	10	2,600.00
	Total			100	$ 3,318.25

a/The Boards estimated cost of compliance with the Renegotiation Act for the company including its subsidiary company would be $260.

b/The Board's estimated cost of compliance with the Renegotiation Act for the company including its subsidiary companies would be $845.

In all three cases, direct labor expenses were calculated by multiplying salary rate and length of time required. All direct labor was increased by 30 percent to account for fringe benefits. No other cost elements were included in the analysis. As shown in the table, the costs to comply increased dramatically when the filing was assigned to a regional board.

We contacted the three contractors included in the Board's analysis. We were able to obtain information at two firms. The large contractor, Martin Marietta, could not prepare cost estimates within the timeframe of our review. The results of work at the medium contractor, Hopeman Brothers, indicates that the estimated costs ascribed to it in the Board's study are understated. The degree to which it is understated cannot be determined.

Regarding the small contractor, Astrosystems, Inc., we believe the estimated costs in the Board's study may have been understated because the Board's estimate did not contain provisions for all of the types of costs that the contractor claims to incur in complying with the Renegotiation Act. Although data obtained from Astrosystems could not be substantiated, we believe it is reasonable to assume that costs of this nature are in fact incurred in complying with the act.

ASTROSYSTEMS, INCORPORATED

Scope and work done

We obtained and reviewed the Astrosystems, Inc., costs of complying with the renegotiation requirements. Our review included discussion of the contractor's support and rationale for the cost data prepared and a test of data in support of the costs. We also reviewed the information contained in the Board's analysis of renegotiation filing costs as it pertained to "A" company by discussions and review of pertinent data at Astrosystems.

Data from contractor included in the Board's study

Astrosystems, Inc., is engaged in the design and manufacture of electronic and electromechanical products for precision monitoring and control of military, aerospace and industrial processes. It has two wholly owned subsidiaries.

Contractor representatives said that Astrosystems files an RB Form 1 (Standard Form of Contractor's Report for Renegotiation) for its consolidated business and also files separate RB-1's for Astrosystems and one of its subsidiaries. We were told that Astrosystems has renegotiable and nonrenegotiable sales and does both prime and subcontract work. The contractor's representatives said that Astrosystems usually files and is granted, for renegotiation purposes, the commercial article exemption and makes use of the exemption for certain durable test equipment it sells.

According to Astrosystems' RB-1 report for its fiscal year ended August 31, 1976, the company's total sales consisted of the following:

	Total (000 omitted)
Renegotiable sales	$2,347
Nonrenegotiable sales	
Commercial article exemption	149
Durable productive equipment exemption	1,048
Other	2,704
Total	$6,248

Astrosystems' costs to comply with the renegotiation requirements were estimated at about $12,600 annually according to information developed by the contractor. These costs were based on its experience in preparing RB-1 filings.

Astrosystems, Incorporated

Annual Costs for Complying with Renegotiation Requirements

Preparation of RB-1 Report	Amount
Order coding, correspondence and followup (as to renegotiability) with customers, analysis and summary of sales invoices including preliminary analysis for durable productive test equipment, commercial article classification, and related supervision	$2,950
Determination of costs and expenses related to renegotiable sales, preparation of RB-1 and supporting schedules	1,950
Determination of commercial class of articles, durable productive test equipment, final management review of RB-1 and schedules	1,500
	$6,400
Fringe benefits (15 percent)	$1,000
	$7,400
Outside accounting and legal costs related to RB-1 preparation, footnote to annual report	5,200
Total	$12,600

The $12,600 company estimate compares with the $260 cost estimate of the Renegotiation Board discussed earlier. Astrosystems' costs are essentially a detailed estimate prepared by the contractor's controller who has been directly involved in the RB-1 preparation. We verified the weekly salary rates and fringe-benefit factor used to determine the costs incurred. To the extent that the costs were based on estimates of personnel time spent on work related to the RB-1 report or were allocations of costs for outside legal and accounting services, they are not, in our opinion, susceptible to audit verification.

We noted that Astrosystems' RB-1 report was supported by a file of worksheets, summarizations and analysis. We also observed a mass of material, supporting worksheets and data which was prepared in response to the Board's assignment of Astrosystems' FY 1969 results. Our observation of these materials and discussions with contractor representatives indicates that substantial effort was involved in complying with the renegotiation requirements.

The Renegotiation Baord analysis

Representatives from Astrosystems disputed the costs contained in the Board's analysis transmitted June 9, 1977, with respect to "A" Company." They stated that they also disagreed with figures they understood had been quoted during hearings on the bill.

According to a copy of a letter of June 2, 1977, Astrosystems wrote to Congressman Lester Wolff, New York, advising him of its estimate ($12,000 per year for filing). The letter states that the costs attributed to Astrosystems "* * *, was not supplied by Astrosystems and in fact is considerably understated."

Astrosystems' representatives said that no one from the Board had contacted them to develop the figures cited in the analysis.

Conclusions

Based on our review, we believe that

--the contractor's estimated costs are documented to the extent possible and were realistically described. However, all of the costs are based on estimated employees' time that is not susceptible to audit verification. Also, it should be noted that costs related to obtaining exemptions are discretionary in that contractors have the option of claiming or not claiming exemptions.

--the costs cited for A Company in the Board's analysis appear to be understated because the Board's estimate did not contain provision for all of the types of costs the contractor claims to incur in complying with the Renegotiation Act.

HOPEMAN BROTHERS, INCORPORATED

Hopeman Brothers, Inc., and its five domestic subsidiary companies had total sales of about $21 million in the year ending December 28, 1975, of which 33 percent were subject to renegotiation. Renegotiable subcontracts were primarily for engineering, manufacturing and installing materials to outfit large marine vessels, particularly the fabrication of light sheet metal desks, chairs, lockers, and other furniture.

We contacted responsible officials at Hopeman Brothers to determine whether compliance cost estimates had been developed. Hopeman Brothers officials told us cost figures had not been developed, but could be prepared within the time frame of our review.

At our request, Hopeman Brothers' personnel performed an analysis of the time required to comply with the Renegotiation Act.

Hopeman Brothers did not compile costs to comply with renegotiation requirements as they were incurred. Rather, the estimates of direct time were based on employee recollection supplemented by the working papers retained by Hopeman Brothers which were used to file renegotiation reports. Hopeman Brothers officials acknowledge that their estimates are not documented but believe them to be conservative.

Several Hopeman Brothers' officials were directly involved in the renegotiation process. The officials worked on renegotiation matters on an as-needed basis. All renegotiation efforts were made after all tax and financial accounting requirements were completed. Since the employees involved generally spent only a small fraction of their time on renegotiation matters, we were advised that no employees would be laid off or positions eliminated if there were no Renegotiation Act. Hopeman Brothers' employees are not relieved of other duties to deal with renegotiation matters, but they believe that productive, alternative work would be available if there were no Renegotiation Act requirements.

Estimates of costs for most recent filing (not assigned)

Hopeman Brothers submits a total of six filings per year for itself and subsidiaries. As shown below, Hopeman Brothers estimated its costs for the most recent filing to be about $2,045.

Direct salary expense (18 days, total of 4 employees)	$1,645
Fringe benefits at approximately 25 percent	400
Total cost of FY 1975 filing	$2,045

The $2,045 company cost estimate compares with the $845 cost estimate of the Renegotiation Board discussed earlier. This filing had not been assigned to a regional board. Hopeman Brother' officials identified eight tasks which were necessary to comply with the renegotiation process beyond all other tax and accounting requirements. It was estimated that 18 days of direct time were required to complete the filing. In addition to employee salaries, fringe benefits, including Social Security contributions, retirement, insurance, vacation and holidays were estimated to be about 25 percent.

<u>Cost effect of assignment</u>

Hopeman Brothers' 1971 and 1972 filings were assigned by the Board. Hopeman Brothers estimated that direct salary costs for the assignment to be $44,000, plus fringe benefits of 25 percent, and overhead costs of $5,000, for total costs of about $60,000. This included about 11 months of employees' and officers' time and 3 weeks' time for consultations with a public accounting firm over a 4-year period (1972-1976). Hopeman Brothers relied to a great extent on memory to prepare these estimates for the 4-year assignment period.

The largest tasks were: (1) to complete a request for significant detail in March 1974, which Hopeman Brothers estimated took at least 4 weeks; and (2) to prepare "Section 0 - Statement of Factors" which Hopeman Brothers estimated took about 25 days for officers and employees to complete. According to Hopeman Brothers' officials, one employee spent 3 days with a Renegotiation Board auditor during a field visit and three officers spent 1 day with Board personnel during a subsequent visit.

Hopeman Brothers stated that their top management supervises the daily operations of the company. They do not have staff personnel competent to handle renegotiation. Thus, renegotiation increases the burden of their top management, and thereby reduces their effectiveness in running the company. Cost impact of this reduction in supervision, in Hopeman Brothers' opinion, exceeded the direct costs given above.

Hopeman Brothers' estimate of $60,000 includes the assignment of two filings for field review. Renegotiation Board officials told us that assignments are frequently made for 2 or more fiscal years at a time for economy. They said it is not possible to segregate the costs to comply for each year. The Renegotiation Board study treated both assignments as one. Even though the $60,000 was for two assignments, it is Hopeman Brothers' opinion that most of the renegotiation effort went into the FY 1971 filing. Therefore, they believe the cost of assignment for only this 1 year would have been substantially the same figure as for the 2 years.

Basis for Board estimate for Hopeman Brothers

Renegotiation Board personnel informed us that their cost figures for Hopeman Brothers were based on estimates of the amount of time spent complying with Board requirements. This amounted to one person working 2 days on the initial filing and 4 weeks on the assignment process which extended over a 4 year period. The Board's percent figure for fringe benefits was 20 percent higher than Hopeman Brothers. Board personnel stated that they only covered the cost of Hopeman Brothers headquarters filings, and did not include the cost of filings required for Hopeman Brothers subsidiaries.

Conclusion

We reviewed the renegotiation files at Hopeman Brothers and discussed the renegotiation process and their cost estimates with company officials. The level of effort and the resulting costs developed by Hopeman Brothers are estimates which cannot be verified in a precise manner. However, based on a review of available records, we believe the Renegotiation Board's estimate of Hopeman Brothers' costs is understated. The degree to which it is understated cannot be determined.

MARTIN MARIETTA CORPORATION

Martin Marietta Corporation and its affiliates had total sales of about $887 million in the year ending December 31, 1975, of which 31 percent were subject to renegotiation. Martin Marietta Corporation's Aerospace Group had three divisions with renegotiable sales. In addition, Martin Marietta Laboratories, Martin Marietta Aluminum, Inc., and Martin Marietta Aluminum Sales, Inc., had substantial renegotiable sales. Renegotiable sales were primarily for the design, manufacture and testing of missiles, launch vehicles, and other space program items.

Martin Marietta Corporation was included in the Renegotiation Board's analysis of industry costs to comply with renegotiation requirements. We contacted the responsible official at Martin Marietta Corporation to determine whether compliance cost estimates had been developed. We were advised that cost estimates had not been prepared by Martin Marietta Corporation and that estimates could not be prepared for audit within the time frame of our review.