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Report to the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

April 2002

CONTRACT MANAGEMENT

DOD Needs Better Guidance on Granting Waivers for Certified Cost or Pricing Data

G A O

Accountability * Integrity * Reliability

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United States General Accounting Office
Washington, DC 20548

April 22, 2002

The Honorable Daniel K. Akaka
Chairman
The Honorable James M. Inhofe
Ranking Member
Subcommittee on Readiness and
Management Support
Committee on Armed Services
United States Senate

To maximize the value of taxpayer dollars, the federal government generally seeks to award its contracts through competition. However, the government also buys unique products and services, including sophisticated weapons systems, for which it cannot always rely on competition to get the best prices and values. Instead, it must turn to a single source for its procurements. For example, in fiscal year 2000, the Department of Defense (DOD) awarded contracts valued at about $36.2 billion without competition.

In these cases, contractors and subcontractors normally provide the government with cost or pricing data supporting their proposed prices and certify that the data submitted are accurate, complete, and current. This requirement, established by the Truth in Negotiations Act, is meant to protect against inflated prices, by ensuring that the government has the data it needs to effectively negotiate with the contractor. However, the government can waive the requirement for certified data in exceptional cases. In these instances, contracting officers use other techniques to arrive at fair and reasonable prices.

This subcommittee has been concerned about the use of waivers. Without certified data, the government has less information to determine a fair price. A key concern is that regulations do not provide adequate guidance on when waivers should be used. In view of this concern, you requested that we examine (1) the extent to which DOD is using these waivers and why, (2) the data and analyses DOD is relying on to arrive at a price, (3) factors that minimize or increase risks of inflated prices, and (4) whether DOD has provided adequate guidance to minimize these risks. Our scope and methodology are discussed in appendix I.

Results in Brief

Using DOD's contract database, we identified 20 waivers valued at more than $5 million each in fiscal year 2000. The total value of these waivers was about $4.4 billion. In all the cases we reviewed, the contract pricing or waiver documents stated that sufficient information was available to determine the price to be fair and reasonable without the submission of cost or pricing data.

There was a wide spectrum in the quality of the data and analyses being used. On one end, there were situations where the analysis focused only on the bottom-line price and not the supporting costs and where the data being relied on were exceptionally old. On the other end, situations existed where the negotiations were based on data that were very recently certified with little change in the quantity. To further reduce risks, some contracting officers involved pricing experts as well as integrated teams of government and contractor personnel, which collaboratively developed data. Clearly, the government was at a higher risk in situations where there was a lot of uncertainty and at lower risk where there was less uncertainty.

Despite the range of techniques employed to arrive at a price, DOD does not have guidance that would help buying organizations draw the line between what type of data and analyses are acceptable or not and what kinds of outside assistance, such as contracting and pricing experts, should be obtained. Such guidance is important to reduce the risk of inflated prices. In addition, DOD does not have adequate guidance to help contracting officers decide whether a waiver should be granted in the first place. This guidance is needed to limit waivers as much as possible to situations where the government is willing to take a greater risk—such as when there is an urgent need for the item. We are making a recommendation to DOD to develop guidance that better defines when waivers should be used and how prices should be assessed in the event that they are used.

In commenting on a draft of this report, DOD agreed that it should develop guidance along the lines we recommended. However, it disagreed with the need to place this guidance in the Federal Acquisition Regulation. DOD's guidance should help to reduce risks associated with the waiver process. But it is still appropriate to work toward incorporating the guidance into the Federal Acquisition Regulation since the regulation is a definitive source for contract management and it currently lacks clarity on this important issue.

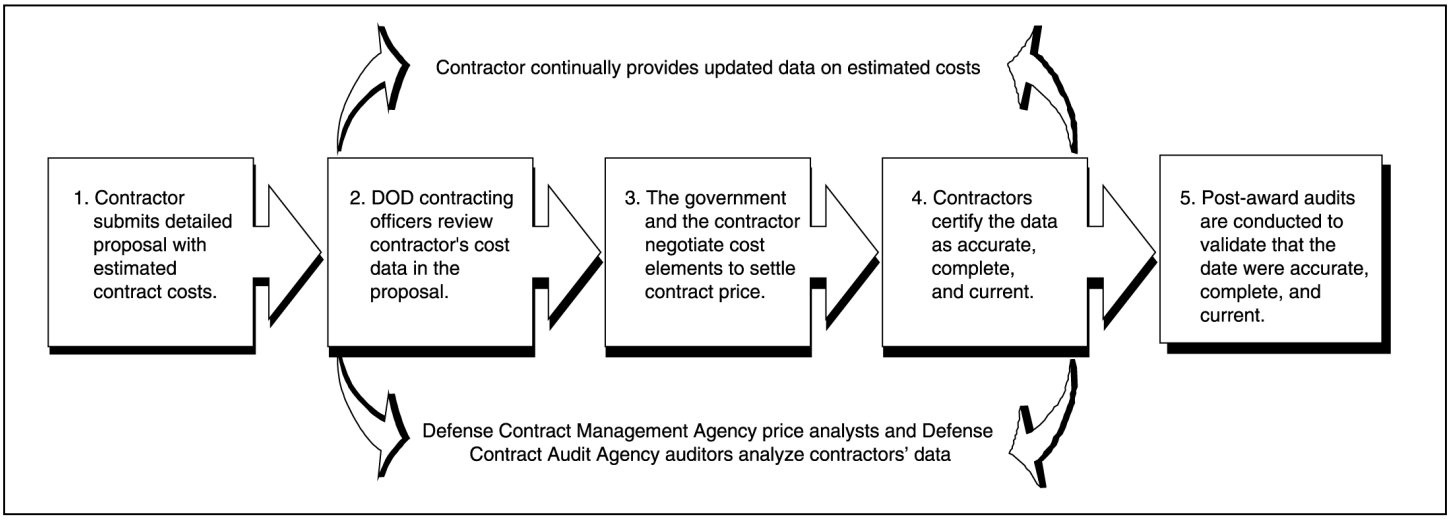
Background

Historically, a principal concern in noncompetitive contracting situations has been how to ensure that the prices proposed by contractors are fair and reasonable. Recognizing this risk, the Congress enacted the Truth in Negotiations Act in 1962. The act represents the government's key safeguard against inflated contract prices on noncompetitive contracts. The act requires contractors and subcontractors to provide the government with cost or pricing data supporting their proposed prices and to certify that the data are accurate, complete, and current.[1] If the government later discovers that the contractor submitted data that were not accurate, complete, and current, the act allows the government to pursue remedies, such as a reduction in the contract price. Interest and penalties can also be assessed under certain conditions. These provisions are designed to give the government the information it needs to ensure fair and reasonable contract prices.

The negotiation process with certified cost or pricing data can be lengthy, and the documentation requirements for both sides can be extensive. The process starts when the contractor provides estimated costs for subcontracts and materials along with a detailed breakdown of the work to be performed, including estimated manufacturing labor costs, engineering costs, tooling costs, and other direct costs for each segment of the work. As figure 1 shows, DOD contracting officers then review these data along with price analysts from the Defense Contract Management Agency and auditors from the Defense Contract Audit Agency. The government and the contractor then negotiate cost elements to settle on a price. Once this is done, the contractor certifies the data as accurate, complete, and current. DOD may conduct an audit after the contract's award.

[1] P.L. 87-653, Sept. 10, 1962. This requirement applies to contract actions above the specified threshold ($550,000 as of fiscal year 2001) unless an exception applies. For example, certified data are not required when the price is based on competition or for the acquisition of commercial items.

Figure 1: Noncompetitive Contracting Process under the Truth in Negotiations Act



When enacted in 1962, the Truth in Negotiations Act did not include an explanation of what constituted an "exceptional case" and it has never been amended to define that term. Up until 1995, the Federal Acquisition Regulation (the implementing regulation) largely mirrored the Truth in Negotiations Act. The waiver provision in the Federal Acquisition Regulation was amended in 1995 to allow contracting officers to waive data when sufficient information was available to determine a fair and reasonable price. However, the regulation still provided little guidance on the circumstances that would warrant a waiver in a particular case. The first sentence of the current provision states that the "head of the contracting activity . . . may, without power of delegation, waive the requirement for submission of cost or pricing data in exceptional cases."[2] The waiver provision also states that the head of the contracting activity "may consider waiving the requirement if the price can be determined to be fair and reasonable without submission of cost or pricing data." Aside from stating that a waiver may be considered in this situation, the regulation provides no further guidance on the circumstances that would warrant a waiver. Finally, the regulation includes no other guidance to

[2] The waiver provision is at section 15.403-1(c) (4) of the Federal Acquisition Regulation and is reprinted in appendix II.

help agency officials weigh the potential risks and benefits of granting a waiver in a particular case, as opposed to obtaining certified data.[3]

Members of Congress have expressed concerns about the need to clarify what would constitute an exceptional case for granting a waiver in several instances. For example, the conference report on the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 stated:

> The conferees agree that the term "exceptional circumstances" requires more than the belief that it may be possible to determine the contract price to be fair and reasonable without the submission of certified cost and pricing data. For example, a waiver may be appropriate in circumstances where it is possible to determine price reasonableness without cost or pricing data and the contracting officer determines that it would not be possible to enter into a contract with a particular contractor in the absence of a waiver.

In response to these concerns, DOD was directed in 1998 to work with appropriate executive branch officials to clarify situations in which an exceptional case waiver may be granted.[4] According to DOD, no actions have been taken to clarify when waivers should be granted.

DOD's Use of Waivers for Certified Data

Using DOD's contract database, we identified 20 waivers valued at more than $5 million each in fiscal year 2000.[5] The total value of these waivers was about $4.4 billion. As table 1 shows, six buying organizations approved these waivers. Five of the contracts included waivers that covered multiple-year purchases. Six waivers that we identified involved large, complicated acquisitions, which combined represented about 94 percent of the dollar value of the waivers we reviewed. (See table 2.)

We could not assess the extent to which waivers are being used at DOD because DOD's contract database is unreliable. However, for the contract

[3] The Defense Federal Acquisition Regulation Supplement also includes little guidance on waivers.

[4] See Conference Report on the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999. Report No. 105-736, Sept. 22, 1998.

[5] The contract actions included contact awards as well as contact modifications. Modifications included, for example, exercising an option or funding a contract on an incremental basis. We included waivers that involved contract actions in which pricing was completed prior to fiscal year 2000 in our review when the modification happened in fiscal year 2000.

actions we examined, we were able to verify data by reviewing the actual contracts and supporting documents.

Table 1: Waivers of Certified Cost or Pricing Data (Dollars in Millions)

Buying organization	Number of Contracts	Waiver value
Naval Air Systems Command	2	$437.9
Naval Sea Systems Command	1	$875.7
Naval Inventory Control Point	6	$60.3
Army Tank-Automotive and Armaments Command	2	$234.1
Army Aviation and Missile Command	7	$1,258.2
Air Force Materiel Command (Aeronautical Systems Center)	2	$1,571.2
Total	**20**	**$4,437.4**

Table 2: Contracts Selected for Review (Dollars in Millions)

Service	Weapon system	Value	Contractor
Air Force	F-16 fighter aircraft (foreign military sale to Greece)	$1,521.9	Lockheed Martin
Navy	AEGIS weapon system	$875.7	Lockheed Martin
Army	Black Hawk helicopter engines	$720.0[a]	General Electric
Army	Apache helicopters (remanufacture)	$462.6	Boeing (McDonnell Douglas)
Navy	Tomahawk cruise missiles (remanufacture)	$408.6	Raytheon
Army	Combat vehicle track	$200.1[a]	Goodyear Tire and Rubber
	Subtotal	**$4,188.9**	
Air Force	Predator reconnaissance vehicles	$49.3	General Atomics
Army	Wolverine bridge vehicles	$34.0	General Dynamics
Navy	T-45 Trainer engine	$29.3	Rolls-Royce
Army	Crashworthy extended-range fuel system	$25.9	Robertson Aviation
Army	Chinook engines	$23.3	Honeywell (Allied Signal)
Navy	Orion radar equipment	$16.6	Raytheon (Texas Instruments)
Navy	F/A-18 E/F Super Hornet spare parts	$13.5	General Electric
Army	Hellfire II missiles	$12.2	Hellfire Systems
Navy	F-404 turbine blades	$9.9	General Electric
Army	Chinook engine spares	$7.6	Honeywell (Allied Signal)
Navy	Digital data power groups	$7.4	Data Link Solutions, BAE Systems/Rockwell Collins
Navy	F/A-18 Hornet radar equipment	$6.9	Raytheon (Hughes Aircraft)
Army	Apache fire control radar spare parts	$6.6	Longbow Limited
Navy	Satellite communications equipment	$6.0	Linkabit Wireless
Total		**$4,437.4**	

[a]These were indefinite delivery indefinite quantity (IDIQ) contracts. Some portion of these amounts represents purchases that may occur in fiscal year 2001.

Reasons Why Waivers Were Used

Contract pricing or waiver documents for all of the cases we reviewed stated that sufficient information was available to determine the price to be fair and reasonable without the submission of cost or pricing data and did not cite other circumstances to justify the waivers. This justification complies with the Federal Acquisition Regulation. In three cases, our review found that other factors strongly influenced the decision to waive certified cost or pricing data. These involved purchases for crashworthy fuel systems and combat vehicle track as well as a foreign military sale of F-16 fighter aircraft to Greece.

In the crashworthy fuel system purchase, the company's business model requires the company to sell its products at catalog prices rather than use a traditional government approach based on certified cost or pricing data, which the company never provides. This unique supplier also developed all of its products and maintains a production base exclusively at the company's expense. In the case of the purchase of combat vehicles track, the company's commercial accounting system did not segregate unallowable costs from its overhead accounts, and the company did not want to run the risk of government claims and possible damage to its reputation because of the inadvertent failure to exclude such costs from government proposals. As a result, the company would not provide certified data. The Army and the company agreed to reduce general and administrative costs allocated to this buy by 25 percent to compensate for possible unallowable costs.

Finally, in the F-16 sale, two approaches were considered. The first called for accepting the price offered by the contractor during a competition between different aircraft types. The second called for traditional negotiations based on the certification of cost or pricing data. The contractor objected to providing certified data, arguing that adequate price competition had occurred. As a compromise, the Air Force waived the certification requirement but obtained and analyzed pricing data from the contractor.

Data and Analyses Used to Arrive at Prices

Contracting officers responsible for the 20 waivers we reviewed used a variety of techniques and approaches—sometimes a combination of several—to determine whether prices were fair and reasonable.

Many of the contracting officers conducted a price analysis. Under a price analysis, the contracting officer reviews the proposed price for the contract without a breakdown of supporting costs. In 11 cases, the contracting officers compared contractors' proposed prices with prices

that had been negotiated previously for the same systems with certified data. In some cases, if a significant amount of time had elapsed since the previous price had been established, the contracting officers adjusted the price to account for inflation and quantity changes.

In four cases, contracting officers conducted more thorough analyses using the contractors' cost data, but the contractors were not required to certify the data as accurate, complete, or current. Under a cost analysis, the contracting officer reviews a breakdown of supporting costs in terms of materials, labor, and various overhead accounts. Such a breakdown, for example, could list various prices for materials as well as anticipated hours and rates for labor.

In five cases, a variety of other pricing techniques were employed, including the use of regression analyses,[6] learning curves,[7] and parametric estimates.[8]

Table 3 summarizes primary techniques employed on each of the 20 waivers we reviewed.

Table 3: Techniques Primarily Employed to Analyze Contractor Proposals

	Primary Techniques			
System	**Price analysis using prior certified prices**	**Cost analysis using uncertified data**	**Other**	**Comments/Other techniques**
Tomahawk cruise missiles (remanufacture)		X		Regression analysis of 1992-97 historical prices.
T-45 Trainer engine			X	Reviewed contractor's performance on prior contracts.
AEGIS weapon system			X	Price analysis of historical prices and costs; cost analysis for selected elements using uncertified data.
Orion radar equipment	X			
F/A-18 E/F Super Hornet spare parts		X		Price analysis on most parts under preceding contracts.

[6] A statistical technique used to establish the relationship among variables (such as direct labor and overhead costs).

[7] A technique for projecting the amount of direct labor or material that will be used to manufacture a product on a repetitive basis.

[8] A technique employing one or more cost estimating relationships to estimate costs associated with the development, manufacture, or modification of an end item.

	Primary Techniques			
System	Price analysis using prior certified prices	Cost analysis using uncertified data	Other	Comments/Other techniques
F-404 turbine blades	X			
Digital Data Power Groups	X			
F/A-18 Hornet radar equipment	X			Price analysis of other Navy contracts.
Satellite communications equipment	X			Price analysis of other Navy contracts.
Black Hawk helicopter engines	X			
Apache helicopters (remanufacture)			X	Price analysis of historical prices and cost analysis of subcontract material. Regression analysis and learning curve estimate on historical labor costs.
Crashworthy extended range fuel system			X	Parametric estimate.
Chinook engines	X			
Hellfire II missiles	X			Review of procurement history and independent government estimate.
Apache fire control radar spares		X		
Chinook engine spares	X			
Combat vehicle track		X		
Wolverine bridge vehicles	X			
F-16 fighter aircraft (foreign military sale to Greece)			X	Price analysis (prices negotiated during competitions between F-16 and other aircraft) and review of model used within company to prepare budget estimates.
Predator reconnaissance vehicles	X			
Total	**11**	**4**	**5**	

Risk Depends Largely on Certainty of Data Being Used to Support Analyses

The government was at a higher risk of inflated pricing in situations where there was a lot of uncertainty about the data used to support analyses and a lower risk in situations where there was less uncertainty. Factors that increased uncertainty included changes in the design of the weapon system since a previous purchase, changes in the processes or equipment used to produce the system, or even changes in the amount being ordered by the government. More indirect factors contributing to uncertainty include mergers and acquisitions, cost-cutting measures, or changes in relationships with subcontractors. All of these things can significantly affect the costs of a product.

The practice of relying on previously certified data that are fairly old also increased risk—principally because it increased the potential for more uncertainty. In several cases we reviewed, the data relied on were 2 to 3 years old. At times, contracting officers took action to make up for the uncertainties associated with the time elapsed, such as adjusting the price to account for inflation. However, the contracting officers still could not be assured that all other conditions—such as production processes, business processes, subcontractor relationships— affecting the purchase remained the same. One case we identified, the Navy's purchase of spare parts for Orion radar systems, was particularly risky—not only because the contracting officer relied on 7-year-old data, but the data had never been certified.

We also identified factors and practices that helped to minimize risk. Of course, relying on data that were certified fairly recently for systems where conditions had not changed lowered the risk to the government. This occurred in several cases that we reviewed.

In other cases, contracting officers employed pricing experts from the Defense Contract Management Agency and the Defense Contract Audit Agency to help them analyze costs and/or prices. Such officials lent substantial expertise and experience to the negotiation process by performing audits and reviews of the contractor's purchasing systems, estimating systems, overhead rates, and operations in general.

In some cases, government and contractor personnel worked collaboratively and effectively within integrated product teams to analyze costs and prices. In doing so, they shared and used the same data to come to a consensus on issues affecting contract price. This arrangement also served to minimize the development of adversarial relationships between the contractor and the government.

Another factor that could lower risk is the contractor's having sound estimating and purchasing systems—ones approved by government organizations. Such systems are integral to producing credible proposals. Nearly all of the contractors in the cases that we reviewed had such systems, and in a few cases, allowed government representatives direct access to the data within the systems. Specific examples highlighting risk factors are provided in the figure below.

Figure 2: Examples Highlighting Factors Impacting Risk

Decreased risk	Increased risk
● In purchasing data-processing equipment for about $7.4 million from Data Link Solutions, the Naval Inventory Control Point relied on certified cost data from a contract negotiated 4 months prior for the same equipment.	● The Naval Inventory Control Point purchased spare parts for the Navy's Orion radar system from Raytheon (formerly Texas Instruments) for about $16.6 million. Prices negotiated in 1996 between the Naval Air Systems Command and Texas Instruments were used as a basis for determining that the contractor's price was fair and reasonable. Although the contracting officer believed the 1996 prices had been based on certified data, in fact, certified data had not been obtained. Rather, we found that the prices for the 1996 contract were based on a 1993 commitment by Texas instruments to sell the radar parts at a specified price.
● The Army awarded a $2.3 billion contract to Boeing (formerly McDonnell Douglas) to remanufacture 269 Apache Longbow helicopters. The requirement for certified cost or pricing data was waived on only about 20 percent of the contract value, or $462.6 million, while the balance of costs under the contract was certified. The government waived certified data for the subcontractor's recurring material costs as well as the prime contractor's recurring labor costs. On the subcontractor material costs, an integrated product team--comprising contractor and government representatives, including analysts from the Defense Contract Management Agency and the Defense Contract Audit Agency-challenged subcontractors to reduce, by as much as 20 percent, subcontract prices awarded under a prior remanufacturing contract. As an incentive to subcontractors, the team recommended waivers of the requirement for certified data. For the recurring labor costs, the contractor prepared a regression analysis and developed a learning curve to project recurring labor hours on the basis of historical experience on over 100 prior remanufactured helicopters.	● The Air Force purchased 60 F-16 fighter aircraft from Lockheed Martin in support of a foreign military sale to Greece at about $1.5 billion. This contract called for the production of a new version, which included modifications to existing equipment. This configuration had not been purchased before with certified cost or pricing data. Risk was increased for this situation because the contractor did not use its normal cost-estimating system to generate its proposal. Instead, the contractor's cost buildup relied on a cost model used to prepare budget estimates and certain commercial proposals; the model had not been used to prepare price proposals for government contracts using certified data covered under the Truth in Negotiation Act. Additionally, the waiver was based on comparisons to purchases under two similar programs involving sales to Israel and Norway. Under the Israeli sale, price had been established through a competition with the F-15 aircraft. Norway was still conducting its competition in which the F-16 was competing against a European aircraft. Because there were differences between the aircraft sold to Greece and those sold or offered to Norway, the Air Force also had to make subjective comparisons for nonrecurring tasks.

Decreased risk	Increased risk
● In purchasing $49.3 million worth of Predator unmanned aerial vehicles and ancillary equipment from General Atomics, the Air Force included a defective pricing clause, allowing the government remedies, such as a reduction in contract price, if certified data on which the previous contract had relied on were found not to be accurate, complete, and current. The Air Force also used an integrated product team to help negotiate the price. The team included analysts from the Defense Contract Management Agency and Defense Audit Contract Agency. The acquisition was based on certified data that were less than a year old for the same equipment.	● The Naval Air Systems Command awarded a $408.6 million contract to Raytheon to remanufacture Tomahawk cruise missiles, which involved upgrading payload guidance, and propulsion systems. For negotiations, the contractor provided the government with high-level cost data. Documents in the contract file stated that because Raytheon had never remanufactured two of the four variants covered under the contract and because the contractor had not prepared a complete price proposal, there was some uncertainty about the risks being assumed by the contractor. Recognizing that uncertainty, and in order to arrive at a price on an expedited basis, the Navy included an additional $25.8 million in the contract.
● Under a basic ordering agreement, the government ordered 756 different spare parts in support of the engine of the F/A-18 E/F Super Hornet aircraft from General Electric. These parts ranged in value from less than a dollar to about $258,000. General Electric's proposed price of $14.6 million was developed from an approved cost-estimating system. Moreover, consistent with normal practices with certified data, the Navy requested that Defense Contract Audit Agency review General Electric's proposed costs on the 11 highest value parts, which covered about $10.7 million, or about 73 percent of the total proposal. The Navy also performed a price analysis of prices paid on these 11 parts and most of the other parts under preceding contracts, which were based on certified cost or pricing data. Ultimately, the price was negotiated at $13.5 million, or about a 7.3-percent reduction from the proposed price.	

DOD's Guidance on the Waiver Process Is Not Adequate

DOD's guidance on the waiver process is not adequate. First, DOD does not have guidance that would help clarify for buying organizations what an "exceptional" case might actually entail. The Truth in Negotiations Act does not define exceptional cases and the regulatory guidance is limited. The current guidance states that the head of the contracting activity may consider waiving the requirement if the price can be determined to be fair and reasonable without the submission of cost or pricing data. But the guidance cites only one example of a situation where a waiver may be granted: "if cost or pricing data were furnished on previous production buys and the contracting officer determines such data are sufficient, when combined with updated information."

The trade-offs and complexities involved in making the decision to grant a waiver require more guidance. On the one hand, the certification process

greatly lowers the risk of inflated pricing and provides the government with recourse in the event that items are found to be defectively priced. In fact, in fiscal year 2000, Defense Contract Audit Agency audits related to the Truth in Negotiations Act identified potential cost savings of $4.9 billion.[9] On the other hand, the certification process can be costly to both the contractor and the government in terms of time, effort, and money. And there may be times—such as when there is an urgent need for the item or when the same item was purchased very recently using certified data—when the government may be willing to take a greater risk. By developing more detailed guidance, DOD could help buying organizations weigh these trade-offs and avoid using the waiver process as merely a shortcut to getting an item, even an expensive weapon system, quicker and easier.

Second, DOD does not have guidance that would help buying organizations draw the line between what type of data and analyses would be acceptable or not and what kinds of outside assistance, such as DOD contracting and pricing experts, should be obtained. Our analysis showed that there was a wide spectrum in the quality of the data and analyses being used. On one end, there were situations where the analysis focused only on the bottom-line price and not the supporting costs and where the data being relied on were exceptionally old. On the other end, were situations where the negotiations were based on data that were very recently certified with little change in quantity. In addition, in some situations, other risk mitigating techniques were employed, such as involving contract and pricing experts. Clearly, it is in DOD's interest to encourage contracting officers to reduce the risk of inflated pricing as much as possible by conducting more rigorous analyses and taking advantage of DOD's pricing and contracting expertise.

Third, we identified several issues, not covered within existing guidance, where there was some confusion on what the law and regulations allowed. For example, contracting officers' views differed on whether the government can obtain a waiver that covers only a portion of costs associated with a procurement. In purchasing Apache helicopters, for example, the government, in fact, obtained a partial waiver covering subcontractor costs and recurring labor costs, estimated at $462.6 million of the total $2.3 billion contract. In contrast, in another case, the

[9] Identified in DOD Inspector General's semiannual reports to the Congress.

contracting officer told us that the regulations do not provide for partial waivers.

Another question that could be clarified is whether waivers can be applied to planned, but unpriced, contract options in later years. Specifically, under contracts which have options that are not priced or under which the price can be redetermined, it is not clear whether a waiver obtained in the first year of the contract should apply to price negotiations that occur in subsequent years of the contract. This question came up with the Army's purchase of combat vehicle track from Goodyear Tire and Rubber. In another related situation involving the Army's purchase of Black Hawk helicopter engines from General Electric, the waiver ultimately covered planned purchases over 5 years under two separate contracting actions.

Conclusions

For the majority of its sole-source purchases, DOD minimizes the risk of inflated pricing by requiring its contractors, under the Truth in Negotiations Act, to provide detailed cost or pricing data to support their proposed prices and certify that the data are accurate, complete, and current. But for several billion dollars in contracts, DOD is at a greater risk of inflated pricing because it is waiving the requirement. In some cases, contracting officers still make a considerable effort to reduce risks, such as performing detailed price or cost analyses, involving pricing and contracting experts, and relying on data that were recently certified. By developing guidance to encourage all contracting officers to take such steps and to help buying organizations weigh the decision to grant waivers, DOD could reduce its risk of inflated pricing even further.

Recommendations for Executive Action

We recommend that the secretary of defense work with the Office of Federal Procurement Policy[10] to develop guidance to be included in the Federal Acquisition Regulation to minimize the risk of inflated pricing when waivers for certified cost or pricing data are granted to its contractors and subcontractors. This guidance should (1) clarify situations in which an exceptional case waiver may be granted, (2) identify what type of data and analyses are recommended for arriving at a price when

[10]The Office of Federal Procurement Policy (OFPP) within the Office of Management and Budget is responsible for the development of governmentwide procurement policy. The Administrator of OFPP chairs the Federal Acquisition Regulation (FAR) Council, which reviews and approves proposed changes to the FAR.

waivers are granted, and (3) identify what kinds of outside assistance should be obtained.

We also recommend that the secretary develop guidance that clarifies whether the government can obtain a partial waiver and what should be done with contracts that have options that are not priced. We further recommend that the secretary survey buying organizations to assess whether additional specific issues not covered within existing guidance need to be clarified.

Agency Comments and Our Evaluation

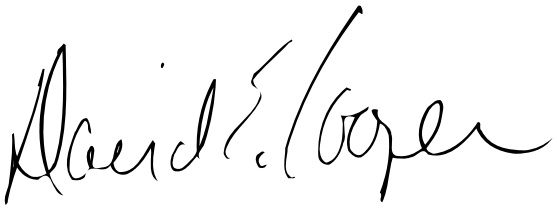
In providing written comments on a draft of this report, DOD generally agreed with our findings and recommendations. Its only disagreement was with our recommendation to work with the Office of Federal Procurement Policy to incorporate new guidance in the Federal Acquisition Regulation.

DOD specifically acknowledged that the age and usefulness of data and analysis should be a concern for contracting officers. In response to our recommendations, DOD intends to develop additional guidance to the contracting community regarding (1) the approval of a waiver of the requirement for cost or pricing data, (2) the types of analyses that should be conducted when waivers are granted, and (3) outside expertise that should be engaged in conducting these analyses. DOD plans to include guidance in a memorandum to the military departments and defense agencies and incorporate it into the next update of its Contract Pricing Reference Guides. DOD also agreed with the need to address partial waivers and waivers on unpriced options. In addition, DOD agreed to survey buying organizations to assess whether specific issues not covered within existing guidance need to be clarified. DOD disagreed with our recommendation to place the revised guidance in the Federal Acquisition Regulation because it believed that such a listing would detract from the application of the best professional judgment by contracting officers.

We believe that DOD is taking constructive measures to reduce risks that come with the waiver process. In addition, we appreciate that providing additional guidance outside the Federal Acquisition Regulation will provide a more immediate benefit than amending the regulation. However, it is still appropriate for DOD to work with OFPP and the FAR Council to incorporate its guidance into the Federal Acquisition Regulation since the guidance would help clarify the regulation and since the regulation is the definitive source for contract management.

We are sending copies of this report to the secretary of defense; the secretaries of the army, navy, and air force; the director, Office of Management and Budget; the administrator, Office of Federal Procurement Policy; and interested congressional committees. We will also make copies available to others on request.

If you have any questions about this report or need additional information, please call me on (202) 512-4841. Key contributors to this report are listed in appendix IV.



David E. Cooper
Director
Acquisition and Sourcing Management

Appendix I: Scope and Methodology

To meet our objectives, we reviewed 20 waivers valued at more than $5 million each in fiscal year 2000 at six buying organizations. In total, the waiver value of these 20 contracts amounted to about $4.4 billion. These 20 waivers involved an array of buying commands, weapon systems, major contractors, and purchasing circumstances.

The DOD contract database was used as the basis to identify sole source, fixed-price weapon system contracts, with more than $5 million in expenditures (or contract actions) in fiscal year 2000. The DOD database includes a variety of contracting actions, such as a basic award of a contract as well as modification of a contract. Modifications could include an exercise of an option to a basic contract or funding of the contract for a specific year on a contract funded on an incremental basis. As a result, in some cases with multiyear buys, the pricing of the contract or modification selected for review occurred before fiscal year 2000.

We selected six commands to visit during this review because these commands, based on DOD's contract database, were the only locations that had individual waivers with more than $5 million in expenditures in fiscal year 2000. These six include the (1) Naval Air Systems Command, (2) Naval Sea Systems Command, (3) Naval Inventory Control Point, (4) Army Tank-Automotive and Armaments Command, (5) Army Aviation and Missile Command, and (6) Aeronautical Systems Center of the Air Force Materiel Command. Because of concerns regarding the reliability of computer-generated data, we also requested the commands to independently review their records to identify any additional waivers meeting these criteria. In total, through the use of the database and independent review process, we identified the 20 contracts with waivers amounting to about $4.4 billion. These six are large buying organizations and visiting these organizations, in our view, gives us visibility into the use of waivers for large contracts nationally in fiscal year 2000.

We reviewed the techniques associated with the methods of pricing the contracts. This review included the data used by contracting officers to determine whether the prices were fair and reasonable. To accomplish this review, we reviewed contract files and held discussions with contracting officers at the DOD buying organizations. In addition, we also held discussions with representatives of most of the contractors to obtain information on the orders as well as DOD officials located at contractor plants.

We conducted our review between March 2001 and April 2002 in accordance with generally accepted government auditing standards.

Appendix II: Federal Acquisition Regulation Provision on Waivers

Below is the waiver provision, which is at section 15.403-1 (c) (4) of the Federal Acquisition Regulation.

The head of the contracting activity (HCA) may, without power of delegation, waive the requirement for submission of cost or pricing data in exceptional cases. The authorization for the waiver and the supporting rationale shall be in writing. The HCA may consider waiving the requirement if the price can be determined to be fair and reasonable without submission of cost or pricing data. For example, if cost or pricing data were furnished on previous production buys and the contracting officer determines such data are sufficient, when combined with updated information, a waiver may be granted. If the HCA has waived the requirement for submission of cost or pricing data, the contractor or higher-tier subcontractor to whom the waiver relates shall be considered as having been required to provide cost or pricing data. Consequently, award of any lower-tier subcontract expected to exceed the cost or pricing data threshold requires the submission of cost or pricing data unless—

1. An exception otherwise applies to the subcontract; or

2. The waiver specifically includes the subcontract and the rationale supporting the waiver for that subcontract.

Appendix III: Comments from the Department of Defense

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ACQUISITION, TECHNOLOGY AND LOGISTICS

DP/CPF

April 09, 2002

Mr. David E. Cooper
Director
Acquisition and Sourcing Management
United States General Accounting Office
Washington, DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report, GAO-02-502, "CONTRACT MANAGEMENT: DoD Needs Better Guidance on Granting Waivers for Certified Cost and Pricing Data," dated March 26, 2002 (Code 120040). The Federal Acquisition Regulation (FAR) at 15.403-1(c)(4) authorizes the Head of the Contracting Activity (HCA) to waive the requirement of the Truth in Negotiations Act (TINA) that a contractor certify that cost or pricing data he submitted is current, accurate, and complete. Such waivers are granted by the HCA in exceptional cases. The GAO reviewed 20 such waivers with a total contract value of $4.4 billion.

Our detailed comments on the recommendations included in the draft report are enclosed. We appreciate the concerns expressed regarding the age and usefulness of the data and analyses used in arriving at fair and reasonable prices on some of the 20 actions reviewed. The quality of data used in performing a price or cost analysis must always be a matter of concern for the contracting officer, irrespective of whether that data has been subject to a TINA certification. We also agree that questions regarding the waiver of certified data for part of a proposed price, and whether unpriced options can be the subject of TINA waivers, need to be addressed. However, we do not agree that the FAR should be the vehicle for addressing these and other pricing issues that may be encountered when considering whether a TINA waiver is warranted. We believe that existing guidance and training should be updated and improved without revision to the FAR. We intend to issue guidance on these matters to the Military Departments and Defense Agencies, and to update the Contract Pricing Reference Guides that are used in our training courses to reflect the expanded guidance.

Thank you for the opportunity to comment on the draft report.

Sincerely,

Deidre A. Lee
Director, Defense Procurement

Enclosure:
As stated

GAO Draft Report
March 26, 2002

"CONTRACT MANAGEMENT: DOD NEEDS BETTER GUIDANCE ON GRANTING WAIVERS FOR CERTIFIED COST AND PRICING DATA"
(CODE 120040)

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense work with the Office of Federal Procurement Policy to develop guidance to be included in the Federal Acquisition Regulation to minimize the risk of inflated pricing when waivers for certified cost and pricing data are granted to its contractors and subcontractors. This guidance should (1) clarify situations in which an exceptional case waiver may be granted, (2) identify what type of data and analyses are recommended for arriving at a price when waivers are granted, and (3) identify what kinds of outside assistance should be obtained.

DOD RESPONSE:

Partially concur. We do not agree that the Federal Acquisition Regulation (FAR) should be the vehicle for addressing these and other pricing issues that may be encountered when considering whether a Truth in Negotiations Act (TINA) waiver is warranted. We believe that existing guidance and training should be updated and improved without revision to the FAR. The Director, Defense Procurement (DDP) will provide additional guidance to the contracting community regarding the approval of a waiver of the requirement for contractor submission of certified cost or pricing data. This guidance will be included in a memorandum to the Military Departments and Defense Agencies that will be issued within sixty days of the publication of a final GAO report. It will be posted on the DDP website at the time of issuance, and also be distributed throughout the Department via an "Info Release." Its contents will be incorporated into the next update of the Contract Pricing Reference Guides, scheduled for completion by September 30, 2002. These guides are used in our training courses and are also available as reference material on the DDP website.

Specifically, the guidance will advise that documentation prepared in support of a request for approval of a TINA waiver

must address any risk to the government of inflated pricing that may result from granting a waiver, and how such risk will be mitigated in arriving at a fair and reasonable price. In addition, contracting officers will be reminded of the need for a thorough price analysis and, to the extent applicable, cost analysis, of information relied on to support a price reasonableness determination in the absence of certified cost or pricing data. They will be further reminded to avail themselves of the expertise that can be provided by the Defense Contract Management Agency, Defense Contract Audit Agency, and other government contracting activities.

We do not concur with that part of the GAO recommendation that additional guidance be included in the FAR with regard to identifying situations that could conceivably support the granting of an exceptional case waiver of certified cost or pricing data. We believe such a listing would detract from the application of the best professional judgment by contracting officers, their management, and HCAs. They may be hesitant to agree to waivers that serve the government's best interests in situations that are not listed; conversely, they may be called upon by contractors to grant waivers in circumstances that meet the definition of "exceptional circumstances" even though a waiver may not otherwise be in the government's best interests.

The contracting officer, management, and the HCA are each responsible for ensuring that the rationale for granting a TINA waiver and the analysis techniques used to determine a fair and reasonable price are properly performed and documented. None of the findings in the draft report indicate that waivers are being granted in an indiscriminant manner, without adequate justification. In sum, we believe the concerns expressed by the GAO in the draft report can be fully addressed in guidance issued to the DoD contracting community without modification of the FAR. We believe it may be counterproductive to list hypothetical exceptional circumstances, whether in the FAR or elsewhere, as it could impede the exercise of professional judgment by the HCA.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense develop guidance that clarifies whether the government can obtain a partial waiver and what should be done with contracts that have options that are not priced.

DOD RESPONSE: Concur. The recommended clarifications will be addressed as part of the additional guidance that the DDP will

provide to the MILDEPs and Defense Agencies in response to recommendation 1.

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense survey buying organizations to assess whether additional specific issues not covered within existing guidance need to be clarified.

DOD RESPONSE: Concur. The DDP will request the senior procurement executives of the Military Departments and Defense Agencies to survey their respective buying activities to assess the need for any additional amplification of existing guidance regarding the granting of TINA waivers. The DDP will include this request in the additional guidance that will be provided to the Military Departments and Defense Agencies in response to recommendation 1.

Appendix IV: GAO Contacts and Staff Acknowledgements

GAO Contacts

David E. Cooper (202) 512-4841
Karen Zuckerstein (202) 512-6785

Staff Acknowledgments

In addition to those named above, Erin Baker, Cristina Chaplain, Ken Graffam, Martin Lobo, Ralph Roffo, John Van Schaik, and Paul Williams made key contributions to this report.

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