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REPORT TO THE CONGRESS

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The Operations And Activities Of The Renegotiation Board

B-163520

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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

B-163520

To the President of the Senate and the
Speaker of the House of Representatives

We have reviewed the operations and activities of the Renegotiation Board.

We made our review in accordance with the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget, and the Chairman, Renegotiation Board.

Comptroller General
of the United States

Contents

ABBREVIATIONS

ASPR	Armed Services Procurement Regulation
DOD	Department of Defense
DS&E	Division of Screening and Exemptions
GAO	General Accounting Office
IRS	Internal Revenue Service
NDPE	new, durable, productive equipment
OMB	Office of Management and Budget
SCA	standard commercial articles
SCAS	standard commercial articles and services

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

THE OPERATIONS AND ACTIVITIES OF THE RENEGOTIATION BOARD
B-163520

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D I G E S T

WHY THE REVIEW WAS MADE

Because of the continued congressional interest to eliminate excessive profits on national defense-related sales, GAO reviewed the operations and activities of the Renegotiation Board. The Board, an independent agency, was created under the Renegotiation Act of 1951 to eliminate contractors' excessive profits on defense and space contracts and related subcontracts.

The current act has been extended 10 times generally for 2-year intervals and will expire June 30, 1973, unless further extended.

The Renegotiation Board has a headquarters office, known as the Statutory Board, in Washington, D.C., and two field offices, one in Washington, D.C., and the other in Los Angeles, California.

Background

In renegotiation the Government, acting through the Board, requires contractors to refund those portions of profits on defense contracts or related subcontracts which are determined to be excessive. A contractor whose total renegotiable sales in a fiscal year exceed $1 million must file a report with the Statutory Board.

The Commission on Government Procurement recommended that

--the Renegotiation Act be extended for 5-year periods,

--the act be amended to cover contracts of all Government agencies,

--the statutory floor be raised from $1 million to $2 million of sales to the Government, and

--the criteria used by the Board to determine excessive profits be expanded and clarified.

GAO generally supports the recommendations but has reservations about raising the statutory floor. If the recommendation to raise the minimum amount of sales subject to renegotiation were accepted, it would allow about one-third of the contractors currently with excessive profits to retain them. This amounts to about $5 million a year. (See p. 47.)

FINDINGS AND CONCLUSIONS

GAO's review indicated that most excessive profit determinations involve small firms (under $10 million in annual sales) which produce low-technology products under fixed-price prime contracts. Large firms often are not subject to excessive profit determinations because they can average profits between diverse operations and because some of their products are exempted under the act. (See p. 44.)
GAO was unable to determine whether excessive profits were made

Tear Sheet

primarily under negotiated or formally advertised contracts. There are some indications that a significant portion of excessive profit determinations may result from formally advertised awards. (See p. 45.)

The Board does not have written guidelines for applying and weighting the statutory factors to be used in excessive profit determinations; instead, the amount of excessive profit is determined by subjectively applying the statutory factors. Written guidelines are needed to assist review officials in evaluating each factor and to allow all review levels to arrive at essentially the same decisions. (See pp. 33 to 35.)

Currently the Board is trying to obtain data from contractors to more accurately determine the rate of return on contractor-provided capital. The Board should issue guidelines to contractors for measuring capital and should develop an analytical framework and criteria for relating the capital-employed factor to renegotiable business. (See 35 and 36.)

The Board has seldom used industry averages in measuring profitability. The proposed use of automatic data processing equipment is expected to enable the development of a historical data base that will encourage and facilitate broadly based comparative financial analyses. (See p. 36.)

Contractors which fail to submit filings, submit inadequate filings, or submit them late are not penalized, and the act provides no penalty for late filings. As a result, contractors do not have an incentive to file with the Board. (See pp. 12 to 14.) In fiscal year 1972 almost half of the refund determinations made by the Board involved delinquent filings. Two of these filings were almost 5 years late. The Government would have recovered, at 4 percent interest, about $450,000 if late filers had been charged interest on the excessive profits held for the time the filings were late. (See p. 13.)

The Board makes many accounting adjustments to contractors' filings. Some of these relate to the segregation of renegotiable and nonrenegotiable sales and to cost allocations which, in turn, alter the profit ratios. The Board reported that, in fiscal year 1970, contractors' filings processed by the regional boards required a net upward adjustment of $191 million, or an increase of about 27 percent in the contractors' reported profits. (See pp. 15 to 17.)

Contractors generally are not required to report information on all their claims in controversy pending against the Government or on those claims settled in their favor, even though amounts of such settlements are renegotiable income. Therefore, contractors which had pending claims and later made recoveries may not report the claims as renegotiable income. (See p. 17.)

The Board has reported voluntary refunds and price reductions from the contractors in its annual reports to the Congress. The Board has implied that these voluntary refunds and price reductions are due, at least in part, to the existence of renegotiation. The amounts are reported by contractors and generally are not verified by the Board. In order for the Congress and the Board to be assured that the amounts reported result

from renegotiation, it appears that some verification of the amounts is necessary. (See p. 17.)

Until recently the Board also did not have written guidelines for the screening process. Most files did not contain information on the reasons for clearing or assigning a filing. The new guidelines if properly implemented, will provide a basis for evaluating whether the screening is consistent and uniform. (See pp. 19 to 21.)

Because of the $1 million statutory floor, exempt sales, and the failure of some contractors to comply with the act, about one-third of defense sales from 1961 to 1970 were not subject to renegotiation. (See pp. 23 and 24.)

In 1954 the Congress provided for a partial exemption of sales of new, durable, productive equipment on the basis that the Government would dispose of large stockpiles of such equipment after the Korean conflict. There are indications that this has not materialized. (See p. 27.)

If the rationale for the exemption of standard commercial articles assumes that competition in the commercial market insures reasonable prices and profits, it may not be valid in all cases. (See pp. 28 and 29.)

The Board, since inception of 1951, has had a minimum amount of excessive profits below which no collections would be made. During fiscal year 1973, the Board increased the minimum from $40,000 to $80,000. To measure the impact of the new minimum, GAO analyzed the excessive profit determinations made in fiscal year 1972. Twenty-nine excessive profit determinations for $1.6 million would not have been made if the new minimum had been in effect that year. (See pp. 29 and 30.)

The Congress transferred jurisdiction to file appeals for redetermining the Board's unilateral orders from the Tax Court to the Court of Claims, effective July 1, 1971. This will affect the appeals in that (1) the burden of proof with respect to excessive profits has been shifted from the contractor to the Government and (2) the Court of Claims has lengthier and costlier pretrial hearings than the Tax Court. Settlements by the Court of Claims thus far have upheld a substantially lower percentage of the Board's determinations than those by the Tax Court. (See pp. 39 to 41.)

The finance offices of the military departments generally received contractors' refunds of excessive profits on time. (See p. 43.)

RECOMMENDATIONS OR SUGGESTIONS

The Board should:

--Develop guidelines to show specifically how the statutory factors are to be applied and weighted and include in files adequate documentation on the rationale for decisions. (See p. 41.)

--Give greater consideration in making excessive profit determinations to the rate of return on capital employed in generating renegotiable sales and use industry averages to provide for more objective and broader based analyses. (See p. 41.)

--Assign filings with seemingly reasonable profits selectively (especially in borderline cases) to the regional boards to insure

that such contractors are not escaping excessive profit determinations because inaccurate data was submitted. (See p. 21.)

--Establish liaison with the Armed Services Board of Contract Appeals and other claims settlement review groups to insure that contractors are reporting accurate data on pending and paid claims. (See p. 22.)

--Consider forwarding to procurement activities data on excessive profit determinations and on the Board's analyses of such determinations. (See p. 46.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Board stated that it had not had sufficient time to provide detailed comments. However, the Board pointed out that it is engaged in an intensive program, still unfinished, the results of which are to some extent evident in this report. Improvements include (1) guidelines for screening, (2) actions that will greatly facilitate an early development of written guidelines for determining excessive profits, and (3) a system of automatic data processing techniques to provide a basis for more broadly based analyses of cases in both screening and full-scale renegotiation.

GAO recognizes that the Board has taken several significant steps to improve the renegotiation process and to establish better means of communicating its method of operation to the public. However, GAO has recommended certain additional actions to (1) lessen the subjectivity of the renegotiation process and thus promote consistency and uniformity, (2) increase assurance that the Board has accurate and complete data, and (3) enable procurement activities to evaluate the reasons why excessive profits occur.

MATTERS FOR CONSIDERATION BY THE CONGRESS

GAO recommends that the Congress:

--Require the Board to obtain and analyze profit and cost data on standard commercial articles and services, to determine whether significant amounts of excessive profits are escaping renegotiation. (See p. 30.)

--Determine whether the new, durable, productive equipment exemption is valid since the rationale for the exemption--the release of Government stockpiled NDPE--has never occurred. (See p. 30.)

--Amend the act to provide penalties for failure to file on time. The penalty could be patterned after that of the Internal Revenue Service; that is, the Board could charge interest on the excessive profits for the period the filing was late or, if no excessive profit determination was made, could charge a fixed amount. (See p. 14.)

--Revise the penalty provision to hold contractors responsible for furnishing all data required by the Board and to have the contractors show reasonable cause why they did not furnish the data. (See p. 22.)

--Consider whether the minimum refunds are appropriate under the act and, if so, whether the Board has clearly stated its objectives for establishing minimums and whether these objectives are being attained. (See p. 30.)

CHAPTER 1

INTRODUCTION

The Renegotiation Act of 1951 (50 U.S.C. app. 1211, 65 Stat. 7 as amended) was established to eliminate contractors' excessive profits on defense and space contracts and related subcontracts. The Renegotiation Board (the Board), an independent agency, was created to administer that act. From its inception through June 30, 1972, the Board made excessive profit determinations of over $1.1 billion before deductions of credits for Federal income and excess profits taxes. The net amount of those determinations after deductions totaled $468 million.

Because of the continued significant amounts of expenditures for national defense and congressional interest, GAO reviewed the operations and activities of the Board for the first time. The scope of our review is described in chapter 11.

HISTORY OF PROFIT-LIMITING LEGISLATION

For many years the Congress has tried to eliminate excessive profits in connection with procurement for national defense. An excess profits tax on defense and nondefense business was enacted during World Wars I and II and during the Korean conflict. During the 1930s two profit-limiting statutes were enacted to cover procurement of naval vessels and military aircraft. Several renegotiation statutes were enacted beginning in 1942 to recover excessive profits made on procurements for national defense.

The Vinson-Trammell Act of 1934 and the Merchant Marine Act of 1936 were the first laws to limit profits on individual contracts for national defense. The Vinson-Trammell Act limited profits on contracts and subcontracts for constructing naval vessels and aircraft. In 1939 the act was amended to include Army aircraft. The Merchant Marine Act limited profits on shipbuilding contracts awarded by the Maritime Commission. Both acts established excessive profits as any excess over a specified percentage of the contract price. Although neither act has been repealed, their profit limitations are suspended while the Renegotiation Act is in effect.

The first Renegotiation Act, enacted in April 1942, provided for renegotiating individual contracts and subcontracts. However, because of the number of war contracts and subcontracts, renegotiation on individual contracts was not practical and contracts were renegotiated in groups, mostly on a fiscal year basis. The Renegotiation Act of 1943 formally established the fiscal year basis and prescribed specific factors to be considered in determining excessive profits. The 1943 act terminated on December 31, 1945. The Congress later enacted the Renegotiation Act of 1948, which carried renegotiation to the effective date of the present act, January 1, 1951. This act was passed in recognition of the impact the Korean conflict was expected to have on the economy. All renegotiation acts before the present act were administered by the agencies involved in the procurements which resulted in excessive profits.

In the 1951 act the Congress declared that excessive profits should be eliminated in the interest of the national defense and the general welfare of the Nation. Although introduced as temporary legislation, the act has been extended 10 times generally at 2-year intervals and will expire on June 30, 1973, unless further extended.

ORGANIZATION OF THE BOARD

The Board has a headquarters office, known as the Statutory Board, in Washington, D.C., and two field offices. One of the field offices, the Eastern Regional Board, is also in Washington, and the other, the Western Regional Board, is in Los Angeles, California. As of June 30, 1972, the Board employed 223 persons: 109 in headquarters, 78 in the Eastern Region, and 36 in the Western Region.

GENERAL PROVISIONS OF THE ACT

In renegotiation the Government, acting through the Board, requires contractors to refund those portions of profits on defense contracts or related subcontracts which

are determined to be excessive.[1] A contractor whose total renegotiable sales in a fiscal year exceed $1 million (statutory floor) must file a report with the Statutory Board. A broker or agent whose renegotiable sales in a fiscal year exceed $25,000 (statutory floor) must also file with the Statutory Board. The act provides that certain articles or services are exempt from renegotiation and need not be included as part of the contractors' renegotiable sales. Contractors whose renegotiable sales are below the statutory floor may report the amount of sales being exempted (without related costs and profits) to the Board, but need not unless that amount was brought below the floor by taking out exempt sales of standard commercial articles or services.

Unless the Board grants a time extension, the filing is due by the first day of the fifth month after the close of the filer's fiscal year. The act provides a penalty for any contractor which willfully fails or refuses to file or furnish information or which knowingly furnishes false or misleading information.

THE RENEGOTIATION PROCESS

After the Statutory Board receives a filing, it makes a desk audit and evaluation to determine whether the data is complete and accurate. This is a cursory review intended to screen out those contractors whose profits are obviously not excessive. In such cases, the Statutory Board sends clearance notices to the contractors. If, however, there is a reasonable possibility of excessive profits, the Statutory Board assigns the filing to one of the regional boards, usually on a geographical basis, for full-scale renegotiation. Generally, if the Board fails to begin renegotiation within a year after receiving a filing, the contractor is not held liable for excessive profits.

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[1]Under the act, renegotiation currently applies to contracts and related subcontracts with the Department of Defense (DOD), Department of the Army, the Department of Navy, the Department of the Air Force, the Maritime Administration, the Federal Maritime Board, the General Services Administration, the National Aeronautics and Space Administration, the Atomic Energy Commission, and the Federal Aviation Agency.

After the regional board obtains any additional information it may need, it analyzes the contractor's accounting system and the method used in allocating costs and expenses between renegotiable and nonrenegotiable business, to determine the amount, if any, of excessive profits. The Board currently has a minimum refund policy under which it will not seek to obtain refunds if the excessive profit is less than $80,000 for contractors and less than $20,000 for brokers or agents.

In cases involving more than $800,000 profit on negotiable sales (class A cases), the regional boards' authority is limited to recommending that the Statutory Board issue a clearance, make a refund agreement with the contractor, or issue a unilateral order for a certain amount if the contractor refuses to enter into a refund agreement.

The Statutory Board has delegated to its regional boards final authority to issue clearances or enter into refund agreements in cases involving renegotiable profits of $800,000 or less (class B cases). The Statutory Board recently rescinded the regional boards' authority to issue unilateral orders in cases when the contractors declined to enter into agreements to eliminate excessive profits; the regulations now require the regional boards to recommend to the Statutory Board the amount of excessive profits.

Proceedings of the Board are informal and nonadversary, and their purpose is to reach agreement with the contractor on the amount of excessive profits. When agreement is not reached, the Board issues a unilateral order for the amount of excessive profits. The contractor can obtain a redetermination of this order by filing a petition in the Court of Claims within 90 days of notice of the order.

CHAPTER 2

FILINGS BY CONTRACTORS ON RENEGOTIABLE SALES

All contractors whose fiscal year renegotiable sales (aggregated sales for companies under common control)[1] exceed the statutory floor are required to file a Standard Form of Contractor's Report (RB-1) with the Statutory Board. Contractors whose renegotiable sales are below the floor may elect to file the Statement of Nonapplicability (RB-90). If the sales were brought below the floor by self-application of the standard commercial article or service exemption, contractors must file an RB-90 or a Report of Self-Exemption.

The Statutory Board's Office of Assignments first reviews a filing. The Office has an identification and statistics division and an analysis division which had a total of 10 professional personnel at June 30, 1972.

During the past 5 fiscal years, the Office processed an average of 4,962 filings a year. It reviews a filing for surface compliance--proper execution, correct designation of fiscal year, etc. If the filing is complete, it is forwarded to the Office of Accounting; if not, the contractor is required to submit the needed data.

METHODS USED TO IDENTIFY NONFILERS

The Board attempts to identify contractors and subcontractors subject to the act which have not filed with the Board through (1) lists of contractors awarded individual contracts of $10,000 or more in a fiscal year, (2) information furnished by contractors filing with the Board, (3) annual DOD lists of contractors with total prime contract awards of

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[1]Generally, for purposes of the act, control may exist by reason of the ownership of more than 50 percent of the voting stock of a corporation or the right to more than 50 percent of the profits of a partnership or joint venture for the fiscal year under review. Renegotiable sales of contractors under common control must be aggregated with those of all other contractors controlled by them or under common control with them.

$1 million or more, (4) newspapers, periodicals, and trade journals, and (5) data furnished by the Internal Revenue Service (IRS) on selected contractors with sales of $1 million or more.

The Board usually identifies manufacturers' agents and brokers through their principals who are required to furnish this information. Anonymous tips sometimes help to identify nonfilers. Firms under common control of a contractor or subcontractor are identified through the reports filed with the Board.

Increasing use of IRS to identify nonfilers

The Board obtained information from IRS on 4,307 contractors for fiscal years 1970 through 1972 and found that about 100 should have filed but did not.

To detect other nonfilers, IRS, at the Board's urging, provided a section on renegotiable sales on the income tax returns for corporations and partnerships. However, Board officials told us that contractors are not completing that section of their returns.

At the time of our review, the Board met with IRS to obtain data on other contractors. They discussed the possibilities of obtaining data from the IRS central computer and making completion of the renegotiable section of the tax return subject to IRS penalty. A Board official stated that the IRS computer could not handle the Board's requirement until 1975.

Because the Board could not obtain data from the computer, no decision has yet been made on whether to have the IRS penalty cover the section of the return relating to renegotiation. Rather, the Board intends to (1) study the impact the penalty might have on the contractors' reporting of the data and (2) determine from a sample of a million or more 1971 corporate tax returns the number of contractors which may have been overlooked in the past. The results of this study, we were informed, would determine the direction and scope of the Board's future effort.

BEST DOCUMENT AVAILABLE

Action taken on nonfilers

On June 30, 1969, the Board had a list of contractors representing about 6,000 annual filings which had not filed but which the Board felt might have been required to file. As of September 8, 1972, this list had been reduced to 916. We were told that possible reasons for this reduction were:

1. Subcontracts are being awarded to fewer companies.

2. The recent increase in mergers and acquisitions has reduced the number of subcontractors.

The Board places contractors identified as nonfilers on a followup list. Once a contractor is on the list, the Board tries to get the contractor to file. As of September 8, 1972, the Board had taken the following actions on the 916 nonfilers.

Action taken	Number of actions
Contractors were mailed letters as part of the preliminary inquiries	140
No followup needed until the internal investigations were completed	4
Tax return and/or Dun and Bradstreet report were requested	27
Contractors were sent letters	322
Contractors were wired	112
Contractors were telephoned	251
Extension was granted to the contractor	1
The Board later found that contractors were not required to file for various reasons	9
Contractors were referred to general counsel for further followup	39
Contractors were referred to the Department of Justice (one contractor for 6 annual filings)	6
Contractors later filed	4
Total actions taken	915
No action taken	1
Total	[a]916

[a]The total actions are for 709 contractors. Contractors which failed to file for several years are listed for each year of nonfiling, bringing the total to 916. The month after the contractor files, its name and year of required filing are removed from the list.

The act provides for a $10,000 fine or up to a year's imprisonment, or both, for contractors which willfully fail or refuse to furnish information to the Board or which knowingly furnish false or misleading information. The penalty has been used only once; in the 1950s a contractor was indicted, but the indictment was rescinded and the fine was not imposed because of the impact it would have had on the community where the contractor was located. From the Board's inception through June 1964, 124 cases of nonfilers were referred to the Department of Justice with the following results. (Since June 1964 only one case--currently pending criminal prosecution--has been referred to the Department of Justice.)

Total referred	124	
Less open cases	1	
Total closed		123
Closed by:		
Case prosecuted and fine levied	1	
Cases dismissed	2	
Filed statutory filings (note a)	59	
Filed below-the-floor filings (note a)	13	
Renegotiable sales regarded as too small to pursue action	20	
Out of business	11	
Withdrawn by the Board	16	
Deceased contractor	1	123

[a]These companies submitted 91 statutory filings and 47 below-the-floor filings, a total of 138 filings.

The major impediment to imposing penalties on nonfilers is the need to prove that contractors willfully failed to file or furnish required data. The Board and the Department of Justice have apparently found it too difficult and time consuming to prove willful intent and seem to have abandoned these efforts. As an alternative, in 1970, the Board gave greater emphasis to the recalcitrant program. The program provided that, if a contractor continued to refuse to file after being notified by the Board, the regional board would issue a unilateral order in an amount to protect the Government's interest.

In fiscal year 1972 the Board sent letters threatening unilateral orders to 52 recalcitrant contractors which had not filed for 2 to 6 fiscal years. The regional boards issued unilateral orders to 11 of these contractors; however, the Statutory Board rescinded them after the contractors filed. Of the remaining contractors, 36 filed reports with the Board and 5 were canceled and removed from the Board's files due to bankruptcy or insolvency.

The recalcitrant program appeared to have been successful in inducing contractors to submit filings and other data needed by the Board; however, it is not now being used since the regional boards are no longer authorized to issue unilateral orders. On March 27, 1973, the Board adopted a procedure whereby contractors that refuse to file or knowingly remain delinquent will be referred more expeditiously to the Department of Justice for enforcement of criminal sanctions.

Need for penalties for late filing

Since the act does not provide a penalty for late filing, the Board has no legal means to encourage contractors to file on time. We discussed this matter with Board officials who agreed that the ability to impose a penalty (such as charging interest on excessive profits due for the period during which the filing was late) should encourage contractors to file on time.

In fiscal year 1972, 85 of the 178 (48 percent) refund determinations made by the Board involved delinquent filings, some of which were late for long periods. For example, in fiscal year 1972 refund determinations totaling $219,000 were made against two contractors whose filings were almost 5 years late. We estimated that, for fiscal year 1972 alone, the Government would have recovered about $450,000 in interest, computed at an annual rate of 4 percent, if late filers had been charged interest on the excessive profits held for the time the filings were late.

CONCLUSIONS

We believe that making completion of the renegotiable sales section on tax returns subject to IRS penalty would be helpful in identifying contractors that should file with the Board. We believe the Board should pursue this matter further with IRS.

Since penalties are not applied to late filers and nonfilers, there is no inducement for them to file on time. Rather, contractors stand to gain financially by not filing with the Board or by delaying their filings as long as possible.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress amend the act to provide reasonable civil penalties for failure to file as required by the act. The penalty could be patterned after that of IRS; that is, the Board could charge interest on the excessive profits for the period the filing was late or, if no excessive profit determination was made, could charge a fixed amount. In either case, the contractor should be required to show reasonable cause why the filing was late.

CHAPTER 3

ACCOUNTING ANALYSIS AND SCREENING FUNCTIONS

The Office of Accounting has eight accountants plus staff which provide technical guidance and assistance to the Statutory Board members, other headquarters staff, and the regional boards. An accountant makes a desk audit of each case, which consists of examining the contractor's accounting data, particularly its segregation of sales and allocation of costs between renegotiable and nonrenegotiable business. If this audit raises any questions, additional information is requested from the contractor. When the audit is completed, the Office prepares a report for screening which certifies the correctness of the segregation of sales and allocation of costs. The contractor's data and the report are then forwarded to the Office of Review, Division of Screening and Exemptions (DS&E), for screening.

The Board has been faced with the problem of obtaining accurate and complete information to make its analyses. The Board has no practical means of requiring contractors to provide timely information which it deems necessary. Although the penalty provision of the act may be imposed when the contractor refuses to furnish adequate data, the Board must prove that the contractor's refusal was willful.

In contrast, IRS penalizes taxpayers for failing to furnish required data if they cannot show reasonable cause for not furnishing the data. The IRS penalty is less severe than the Board's penalty and is more easily applied since IRS need not prove the taxpayers' willful intent. Because of the similarities of taxpayers' and contractors' responsibilities to provide adequate data, we believe a Board penalty like that of IRS would be more effective.

With regard to the accuracy of data, we found that the Board makes many accounting adjustments to contractors' filings. Some of these relate to segregation of renegotiable and nonrenegotiable sales and to cost allocations which, in turn, alter the profit ratios. Most accounting adjustments occur during the regional board review.

We were told that in fiscal year 1972 approximately 10 percent of the 2,104 below-the-floor filings were

converted to above-the-floor filings because contractors improperly segregated sales, failed to report renegotiable business of affiliated or commonly controlled companies, and/or improperly applied exemptions.

Accounting adjustments relate principally to allocating costs. Changes in cost affect the rates of return on capital and net worth. Since the Board allocates contractor capital in proportion to the cost incurred in generating renegotiable and nonrenegotiable sales, a change in cost would require reallocating capital on the basis of the revised cost and would also change the return on capital (profit-on-capital ratio) and net worth (profit-on-net-worth ratio).

In comparing 37 excessive profit determinations, we found that the regional boards had significantly adjusted the accounting data submitted by contractors. The changes, due primarily to reallocating costs, increased the average rate of return on capital by 33 percent and on net worth by 144 percent. Although the cost changes had a smaller effect on the rate of return on sales (profit-sales ratio), we noted rate increases as high as 10 to 20 percent in a few cases.

To determine the accuracy of data, the Board analyzed 800 filings processed in fiscal year 1970 by the regional boards' accounting divisions and found that the contractors' reported profit had a net upward adjustment of $191 million, almost 27 percent higher than the contractors' original reported profit. This analysis did not include a study of the thousands of other filings not assigned to the regional boards. The Board reported there was no indication that this was an abnormal year.

Some reasons why the Board adjusted the reported profits on renegotiable sales follow.

1. Expenses applicable to contractors' nonrenegotiable business were charged to renegotiable business ($15 million).

2. Exemptions from renegotiation were claimed for certain sales that were not entitled to exemption under the act ($1.3 million).

3. Certain depreciation expenses, interest, and bad debts expenses that related to nonrenegotiable sales were charged to renegotiable sales ($2 million).

4. Contractors reported costs applicable to renegotiable sales without reporting all revenues related to such costs (many millions of dollars).

NEED FOR MORE INFORMATION ON SETTLED AND PENDING CLAIMS

Because of the magnitude of contractors' claims in controversy pending against the Government and of the amounts settled in favor of contractors, contractors should report to the Board all pending claims and claims settled during that fiscal year in their initial submissions. The amounts resulting from these claims, when settled, are income subject to renegotiation.

The Board did not require contractors to report pending claims unless their cases had been assigned to the regional boards. The Board considered the impact which pending claims would have on contractors' profitability and included the claims as part of agreements, when deemed necessary, to protect the interests of the Government. However, the Board did not have such information on contractors which were cleared without assignment to the regional boards. Thus, a contractor which had pending claims and which later made recoveries might not report the claims as renegotiable income.

A Board official stated that the forms filed by contractors are being revised to require them to report pending claims. We believe the Board should establish liaison with the Armed Services Board of Contract Appeals and with procurement claims settlement groups to (1) obtain data on amounts recovered by contractors on previously pending claims of which the Board may not have been aware and (2) assure itself that contractors are reporting such amounts as renegotiable business.

Voluntary refunds and price reductions

The Board reports to the Congress annual information it has received from contractors on voluntary refunds and price

reductions. These refunds and price reductions, according to the Board, result from the existence of the act. The Board usually does not determine whether these amounts were voluntary or were required by the contract. It also does not determine whether the refunds (1) were made to the Government or otherwise benefited the Government or (2) could be attributed to the act.

For example, a refund reported to a regional board as voluntary was found to be required by the contract.

In order for the Congress to have the most meaningful information available on how the act affects voluntary refunds, it seems essential that the Board review such refunds, at least on a test basis.

COST PRINCIPLES USED IN RENEGOTIATION

The Armed Services Procurement Regulation (ASPR) governs allowable costs in defense contracts, and IRS standards of cost allowability govern allowable costs for renegotiable business. Examples of costs allowed by the Board but not by ASPR are

--contributions and donations;

--losses on other contracts;

--entertainment;

--interest, financial costs, and related costs (some exceptions); and

--organization costs.

The application of IRS standards can significantly affect the amount of profit reported by contractors. For example, we found that, in applying IRS standards, the Board had permitted one company to allocate in 4 successive years $15,000, $30,000, $34,000, and $31,000 in higher costs than would have been allowed under ASPR. The effect of allowing additional cost items was to decrease reported profits subject to renegotiation. The extent to which such items are allocable to contracts and subcontracts is a matter for determination by the Board.

The Cost Accounting Standards Board regards the Renegotiation Board as a relevant Federal agency under section 719 of the Defense Production Act of 1950, as amended (50 U.S.C. app. 2168). Thus determinations of allocability by the Renegotiation Board should be governed by the rules, regulations, and standards of the Cost Accounting Standards Board.

DIVISION OF SCREENING AND EXEMPTIONS

After receiving a filing and a report for screening from the Office of Accounting, DS&E reviews exemptions self-applied by the contractor for validity and accuracy. DS&E, which has four professionals, decides whether to assign the filing to a regional board or to clear the filing. It does not need the Statutory Board's approval to clear a filing when the renegotiable sales are $10 million or less and/or when renegotiable profits are $200,000 or less. During the past 5 fiscal years, DS&E has screened an average of 4,821 filings a year.

The table below shows DS&E's workload for fiscal years 1968 to 1972.

Fiscal year	Above-the-floor filings				
	Number screened	Cleared		Assigned	
		Number	Percent	Number	Percent
1968	4,354	3,527	81	827	19
1969	4,828	3,858	80	970	20
1970	4,853	4,163	86	690	14
1971	5,442	4,827	89	615	11
1972	4,630	4,197	91	433	9

The table shows that until 1972 the number of above-the-floor filings screened each year increased and that since 1969 DS&E has cleared an increasing percentage of screened filings.

Criteria used in screening

Until recently DS&E did not have formal guidelines for screening filings; instead, we were informed that judgment and experience were the bases for each decision to assign or clear a filing. Officials told us that DS&E considered a number of factors, such as the character of the business,

reasonableness of cost and profit, and value added to the product by the contractor.

Questionable filings are explored further or referred to the five-member Statutory Board for a decision. We were told that documenting reasons for clearances was usually done only in borderline cases.

Because DS&E lacked formal guidelines and adequate documentation on reasons for clearances or assignments, we were unable to evaluate the uniformity and consistency of the screening process. We found that the profit-on-sales factor was the primary consideration in deciding whether to assign or clear borderline filings and that the profit-on-capital and profit-on-net-worth factors were not sufficiently considered. For example, some filings were cleared because the profit-on-sales factors appeared reasonable, even though the profit-on-capital factors were greater than they were in filings that were assigned.

ACTION TAKEN BY THE BOARD

On February 22, 1973, the Chairman of the Board issued an administrative letter on the minimal requirements of an effective screening process with respect to data, analysis, and documentation.

The new rules, in part, require those involved in the screening process to:

1. Make all appropriate accounting adjustments to contractors' data regardless of the assumed outcome of the cases.

2. Explain any problems noted in contractors' sales segregation and the maximum impact of potential adjustments.

3. Include in the records as much data as possible on Government-furnished capital, such as facilities, equipment, and material as well as progress and advance payments. Claims by or against contractors are to be similarly covered.

4. Properly classify contractors' renegotiable sales as to type of industry and include the industries'

financial statistics comparable to the ratios and percentages to be used in evaluating the filings.

5. Explain any clearance of a case which shows that one or more of the three critical profit ratios--returns of sales, total capital, and equity--are above the industry's averages.

The rules for screening also provide that (1) a case of estimated excessive profits not exceeding the minimum refund will require a Board decision on whether to assign it to a regional board and (2) any case assigned to a regional board will include references in the screening report to the relationship between the three critical profit ratios and the industry's averages, as well as data on Government asset input in support of the decision to assign.

CONCLUSIONS

The problems relating to inadequate data are likely to persist because the penalty provision in the act is not effective in getting contractors to submit required data. Also, since significant adjustments are necessary when the regional boards review the filings, it is reasonable to assume that some of the filings being cleared during the screening process are also in need of adjustment and could be escaping excessive profit determinations.

We believe that the Board's proposed change of requiring contractors to report pending claims is a proper step. However, further efforts are needed if the Board is to be assured that contractors report such claims as income when collected.

We believe that the recent guidelines for screening filings should provide a basis for consistent and uniform screening.

RECOMMENDATIONS

We recommend that the Board:

1. Selectively assign filings with seemingly reasonable profits (especially in borderline cases) to the regional boards to insure that such contractors are not escaping excessive profit determinations.

2. Establish liaison with the Armed Services Board of Contract Appeals and other claims settlement review groups to insure that contractors are reporting accurate data on pending and paid claims.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress revise the penalty provision to hold contractors responsible for furnishing all data required by the Board and to have contractors show reasonable cause why they did not furnish the data.

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CHAPTER 4

EXEMPTIONS

There are three different categories of exemptions from renegotiation: exemptions of contractors whose renegotiable sales are below the $1 million statutory floor, exemptions of certain sales provided for in the act, and exemptions of profits.

DEFENSE SALES NOT BEING RENEGOTIATED

Because of the statutory floor, exempt sales, and the failure of some contractors to comply with the act, about one-third of defense procurement sales from 1961 to 1970 were not subject to renegotiation. The estimated amount of sales not renegotiated ranged from almost $12 billion in 1964 to almost $30 billion in 1969.

In its report on "The Efficiency and Effectiveness of Renegotiation Board Operations," dated December 16, 1971, the House Committee on Government Operations estimated that approximately 35 percent of defense sales from 1961 to 1970 were either not reported to the Board or not subject to the act. The following table shows the basis for the Committee's estimate.

Estimated Sales Escaping Renegotiation

Fiscal year	Defense contract sales as adjusted by 1.75 multiplier (note a)	Renegotiable sales reviewed during year (note b)	Estimated sales escaping renegotiation (note c)
	(000,000 omitted)		
1959	$ 44,296	$ -	$ -
1960	41,456	-	-
1961	44,772	25,084	19,212
1962	51,195	29,262	12,194
1963	51,413	31,227	13,545
1964	50,393	39,283	11,912
1965	48,995	34,798	16,615
1966	66,925	31,841	18,552
1967	78,108	33,124	15,871
1968	76,573	38,773	28,152
1969	-	48,495	29,613
1970	-	48,008	28,565
Total	$554,126	$359,895	$194,231

[a] DOD estimated that each dollar of contract sales creates $1.75 in renegotiable sales: $1 for the prime contract, $0.50 for the first-tier subcontract, and $0.25 for the second-tier subcontract.

[b] Normally, 2 years lapse from the time of contract award to the time the contractor files those sales with the Board. Therefore, 1961 renegotiable sales, for example, are deducted from 1959 contract sales to estimate 1961 sales escaping renegotiation.

[c] The total sales subject to the act are substantially more than this estimate because the estimate does not include sales to other Federal agencies covered by the act. As a result, estimated sales escaping renegotiation are understated.

In 1968 DOD awarded contracts, each for over $10,000, to more than 23,000 prime contractors. The Board estimated that over 18,000 of these contractors (representing about $18 billion of sales) escaped renegotiation due to exemptions and the statutory floor, since only about 5,000 filings were received that year.

We were unable to determine the exact amount of sales which are not being renegotiated because (1) many contractors with renegotiable sales below the statutory floor do not file reports and (2) many contractors eligible for mandatory exemptions are taking the exemptions without filing. In either case, these contractors are not required to report to the Board.

SALES EXEMPTIONS

The act provides for 16 exemptions: 9 mandatory exemptions, 1 partially mandatory exemption, 5 permissive exemptions, and a cost allowance for integrated producers[1] of certain agricultural products and raw materials.

Mandatory exemptions include (1) contracts with a territory; a possession; or a State, local, or foreign government, (2) contracts and subcontracts for certain agricultural commodities, (3) contracts and subcontracts for certain raw materials, (4) contracts and subcontracts with common carriers and public utilities, (5) contracts and subcontracts with tax-exempt organizations, (6) contracts which the Board concludes have no direct and immediate connection with the national defense, (7) subcontracts under certain exempt contracts, (8) contracts and subcontracts for standard commercial

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[1] A contractor which produces or acquires the product of a mine, an oil or gas well, or another mineral or natural deposit; timber; or an agricultural product and which processes, refines, or treats such a product beyond the first form or state in which it is customarily sold or in which it has an established market.

articles and services (SCAS)[1] and classes of standard commercial articles (SCA),[2] and (9) competitively bid construction contracts.

The partially mandatory exemption is for new, durable, productive equipment (NDPE).[3]

Permissive exemptions include (1) contracts and subcontracts performed outside the continental United States, (2) contracts and subcontracts for which profits can be determined when the contract prices are established, (3) contracts and subcontracts with provisions adequate to prevent excessive profits, (4) contracts and subcontracts requiring secrecy in the public interest, and (5) subcontracts for which it is not feasible to segregate profits.

Rationale for sales exemptions

We could determine the rationale for only seven sales exemptions. The table below gives the rationale, type of exemption, and applicable act.

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[1]The act defines "SCAS" as articles and services (1) maintained in the vendor's stock or offered for sale in accordance with the vendor's price schedule, (2) whose price is not above the lowest price at which comparable articles are sold for civilian or industrial uses, and (3) which have at least 55 percent of their sales during the fiscal year not subject to renegotiation.

[2]To qualify for this exemption, only one article in a class need be maintained in stock or offered for sale in accordance with a price schedule. Other articles which are of the same kind and content and are sold at reasonably comparable prices may be included in the class, and all are exempt, provided only that 55 percent of the aggregate sales of the articles in the class are nonrenegotiable.

[3]The act defines "NDPE" as new machinery, tools, and other productive equipment with an average useful life of more than 5 years.

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Exemption of contracts and subcontracts	Type	Originally in act of	Rationale
For certain natural resources and raw materials	Mandatory	1942	To recognize immediate availability of competitive price information on world commodity markets.
For certain agricultural commodities	Mandatory	1943	Same as above.
Cost allowance for processors of agricultural commodities and raw materials	Mandatory	1943	To treat integrated producers the same as competitors that may use the two exemptions above.
For certain regulated common carriers	Mandatory	1951, as amended	To recognize effects of other regulations and to avoid conflicts among Federal, State, and local regulatory bodies.
For NDPE	Partially mandatory	1951, as amended	To limit renegotiation to that portion of productive life devoted to defense-related operations and to protect industry from effects of widespread dumping of Government-owned surpluses.
For SCAS and classes of SCA	Mandatory, but contractor has waiver option	1943	To acknowledge pricing experience of the competitive commercial market.
When performed outside the continental United States	Permissive	1942	To acknowledge the difficulty of renegotiating such contracts and subcontracts.

All but three of the above exemptions have been a part of renegotiation since they first appeared in the act. The exemptions for SCAS and for contracts and subcontracts performed outside the continental United States and the cost allowance for integrated producers of certain agricultural commodities and raw materials were first contained in the World War II acts. They were excluded from the 1948 act but reappeared in the 1951 act, as amended.

It is not possible to estimate the amount of profits which escape renegotiation due to sales exemptions and the statutory floor. Contractors to which the mandatory exemptions (except for SCAS) apply are not required to file with the Board if their net renegotiable sales are below the floor. The Board also does not require contractors entitled to the NDPE, SCAS, and permissive exemptions to report profit data on exempted items because it feels it lacks the legal authority to obtain such data.

The Board does, however, have access to information on the amounts of sales which escaped renegotiation in recent years due to the NDPE and SCAS exemptions. The following table shows these amounts.

Year	NDPE	SCAS	Total renegotiated sales	NDPE as percent of sales (note a)	SCAS as percent of sales
	(000,000 omitted)				
1972	(b)	$ 855	$31,264	-	2.7
1971	$27	1,490	51,639	-	2.9
1970	26	1,556	48,008	-	3.2
1969	11	2,192	48,495	-	4.5

[a]Less than 1 percent

[b]Not available.

Effects of NDPE exemption

In drafting the act during the Korean conflict, the Congress believed that NDPE purchased by prime contractors to produce defense articles would revert to commercial use after the war and that the entire productive life of NDPE would not be used in defense-related production. Therefore, the Congress provided that a portion of NDPE sales to prime contractors would be excluded from renegotiation. In 1954 the Congress provided that a portion of NDPE sales directly to the Government would also be excluded from renegotiation. It felt that, since the Government had purchased large quantities of NDPE during the war, the Government's disposal of stockpiled NDPE could threaten future NDPE sales.

We were unable to determine the impact that prime contractors' procurement of NDPE during the war had on NDPE producers' sales after the war. We were told that the Government's purchases of NDPE under the act have not affected NDPE producers' sales because the expected disposal of stockpiled NDPE held by the Government has not yet occurred.

Although the total amount of NDPE sales which escaped renegotiation was, for example, only $64 million during a recent 3-year period, the Congress may want to reconsider whether NDPE sales should continue to be exempt from renegotiation.

Effects of SCAS exemption

Proponents defend this exemption with the following arguments.

1. Pricing experience in the commercial market is adequate to insure fair and reasonable prices and profits.

2. The Government should not be entitled to purchase products and services at prices lower than the general public is willing to pay unless the contractor agrees.

3. Repeal would cause excessive and redundant review of contracts awarded competitively.

4. Repeal would place an additional administrative burden on contractors and the Board.

Advocates of repeal make the following arguments.

1. Many items under the exemption are sold exclusively to the Government and are not subject to commercial market conditions.

2. Competition may not insure fair and reasonable profits.

3. A fair price in the commercial market may be excessive for large Government purchases, and volume purchases may exceed the expected quantity on which the catalog price was established.

4. Contractors have an option to exclude SCAS sales with high profits and include SCAS sales with low profits to reduce their average renegotiable profits.

5. Since contractors must keep substantial records to support their exemption claims, repeal would not significantly increase their administrative workloads. Since the Board must review all exemption claims, repeal also would not significantly increase its administrative workload.

It is not possible to determine, on the basis of information available to the Board, the extent to which a contractor has excluded SCAS sales with high profits and included SCAS sales with low profits in its report on renegotiable sales because of the absence of cost and profit data on exempted items.

The Board has recommended that the Congress repeal the SCAS exemption but has been unable to provide data showing that substantial profits escape renegotiation due to the exemption.

To summarize, it is apparent that:

1. A significant amount of sales (about 3 percent of renegotiated sales) has escaped renegotiation in recent years due to the exemption, but the amount of profits escaping renegotiation is indeterminate.

2. Cost and profit data on all SCAS sales is needed before it can be determined whether contractors use the waiver option to reduce profits on renegotiable sales.

3. If the rationale of the exemption assumes that competition in the commercial market insures reasonable prices and profits, it may not be valid in all cases. A commercial item which is produced by a sole-source supplier and which qualifies for the exemption has not necessarily been subject to competition, and the price quoted in a contractor's catalog may include an unusually high profit margin. Yet the existence of effective competition is presumed. If, however, the rationale of the exemption assumes that the Government is not entitled to any lower prices than the general public is willing to pay regardless of the profits involved, the exemption may be working as intended.

PROFIT EXEMPTIONS

The Board, since inception in 1951, has had a minimum amount of excessive profits below which it would make no collections. In 1954 the Board increased the minimum to $40,000 for contractors and $10,000 for manufacturers' agents and brokers. The Board took the position that, due to the

subjectivity in the renegotiation process, the amount of excessive profits could not be precisely determined.

During fiscal year 1973 the Board increased the minimums to $80,000 for contractors and $20,000 for manufacturers' agents and brokers. The Board stated that it had increased the minimums to reflect inflationary trends in the Board's cost and to assist and protect small businesses.

To measure the impact of the new minimums, we analyzed the excessive profit determinations made in fiscal year 1972 and found that 29 excessive profit determinations for $1.6 million would not have been made had the new minimum been in effect that year.

Board officials told us that recoveries below the minimums are not advisable because refunds are further reduced by credits for Federal income tax and State income tax adjustments. Also, the Government incurs additional costs if contractors appeal to the courts.

RECOMMENDATION TO THE CONGRESS

The Congress should consider whether the minimums are appropriate under the act and, if so, whether the Board has clearly stated its objectives for establishing minimums and whether these objectives are being attained.

The Congress should also:

1. Require the Board to obtain and analyze profit and cost data on SCAS to determine whether significant amounts of excessive profits are escaping.

2. Determine whether the NDPE exemption is valid since the rationale for the exemption--the release of Government stockpiled NDPE--has never occurred.

CHAPTER 5

EXCESSIVE PROFIT DETERMINATIONS

The act does not provide any measurable, objective standards upon which to base excessive profit determinations. Rather, the act and its implementing regulations provide that, in determining excessive profits, the Board consider the contractors' efficiency in attaining quantity and quality production, cost reduction, and economy. The Board also is to consider these statutory factors.

--Reasonableness of costs and profits with particular regard to volume of production, normal earnings, and comparison of wartime and peacetime products.

--The net worth with particular regard to the amount and source of public and private capital employed.

--Extent of risk assumed, including the risk incident to reasonable pricing policies.

--Nature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and contractors in supplying technical assistance.

--Character of business, including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turnover.

--Such other factors the consideration of which the public interest and fair and equitable dealing may require, which factors shall be published in the Board's regulations.

RENEGOTIATION PROCESS

Regional board review

Upon receipt of an assignment by a regional board, a renegotiator and an accountant are assigned to the case. They examine information submitted by the contractor and determine what additional data, if any, is needed. After

they have considered the information, they prepare a Renegotiation Report which includes financial schedules and other accounting data; the contractor's representations of the statutory factors; an analysis and evaluation of the case; and a recommendation on the amount, if any, of excessive profits for the fiscal year under review.

The Statutory Board has delegated to the regional boards final authority to issue clearances or to make refund agreements in cases involving renegotiable profits of $800,000 or less (class B cases). In cases involving renegotiable profits of more than $800,000 (class A cases), the regional boards' authority is limited to making a recommendation that the Statutory Board issue a clearance, make a refund agreement with the contractor, or issue a unilateral order for a certain amount if the contractor refuses to enter into a refund agreement. The case is then reassigned to the Statutory Board for final disposition.

Before final action by the regional board, the contractor has an opportunity to meet with a regional board panel to discuss the Renegotiation Report and all other matters related to the case. If the contractor declines to enter into an agreement after that meeting, the panel gives its recommendation to the regional board. The final recommendation may differ from the recommendations made by the renegotiator and the panel.

Statutory Board review

The Statutory Board reviews each case reassigned from a regional board and makes an independent evaluation. Each case is assigned either to the Statutory Board or to a committee.[1] The Statutory Board or the committee is not limited in any matter by any evaluation or recommendation made by a regional board.

The Office of Review, the Office of General Counsel, and the Office of Accounting serve as the Statutory Board's staff in this review. Contractors have an opportunity to meet with the Statutory Board or the committee before an

[1] The Board refers to this committee as a division of the Statutory Board, which consists of one or more members of the Statutory Board assisted by staff personnel.

excessive profit determination is made. Before such a meeting the contractor is given a Notice of Points for Presentation which summarizes all matters to be presented to the Statutory Board or the committee. If the contractor declines to enter an agreement, the Statutory Board states its finding and issues a Memorandum of Decision to the contractor. If the contractor then agrees, the determination is made by agreement. If the contractor does not agree, the Statutory Board issues a unilateral order.

Until recently, the Board provided the contractor with a summary of facts and reasons which did not address specific points supporting the determination. During our review the Board replaced this summary with the Memorandum of Decision. Although the Memorandum is intended to provide the basis for the decision, it will not do so clearly unless the Board establishes guidelines to show the relative significance of the statutory factors and how they are applied and weighted.

NEED FOR GUIDELINES FOR APPLYING STATUTORY FACTORS

Although we found that the statutory factors were considered in all cases with excessive profits, the Board lacks written guidelines for applying and weighting them. Rather, the Board, on the basis of its experience and expertise, determines the amount of excessive profits, if any, by subjectively applying the factors. Because of the lack of written guidelines, we were unable to evaluate the Board's uniformity and consistency in applying the factors.

Renegotiation Board Operational Bulletin 60-14 states that:

> "* * * to the fullest extent possible, the reasoning process expressed in * * * [determining excessive profits] should be such as to warrant the conclusion that any reasonable and fair-minded man, exercising an informed business judgment, would be likely to reach approximately the same result."

We reviewed 209 of 360 class A and B cases during the past few years in which contractors had declined to enter

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into agreements to eliminate excessive profits. The following table indicates the number of the renegotiator's and/or panel's recommendations which the regional boards adjusted and the number of the regional boards' determinations which the Statutory Board adjusted.

		Regional boards		Statutory Board	
Case type	Number of cases reviewed	Number of cases adjusted	Net amount of adjustment	Number of cases adjusted	Net amount of adjustment
			(000 omitted)		(000 omitted)
Class A	97	32	$ 385	59	-$4,835
Class B	112	38	-4,105	65	-1,808
Total	209	70	-$3,720	124	-$6,643

The Statutory Board concurred in the regional boards' recommendations in only 85 of the 209 cases.

Board officials said that many of the adjustments evolved from (1) contractors' submission of new information to strengthen their representations, (2) differences with the regions on the allowability of costs, and (3) policy issues. For example, a regional board's recommendation on excessive profits was reduced 29 percent (from $425,000 to $300,000) after the committee decided that the regional board had not sufficiently considered the contractor's character-of-business, risk, and reasonableness-of-costs factors. The Statutory Board concurred with the committee. Without guidelines for making determinations and without specific reasons for the adjustments, we could not evaluate the reasonableness of the adjustments.

Since the Board lacks written guidelines for applying the statutory factors and for documenting the weight of each factor, Board officials involved with the appeal process are not aware of how subordinate officials consider the factors. Similarly, subordinate officials are not aware of how Board officials want the factors to be applied. Although it may not have been possible to obtain consensus about the guidelines when renegotiation was first adopted, we believe that, after 20 years of experience and thousands of cases, the Board should be able to do so now.

Considering the amounts of excessive profits and the subjectivity used in determining these amounts, we believe that such guidelines are necessary to assist review officials in evaluating each factor and to allow all review levels to arrive at essentially the same decisions. The Board should especially try to develop and publicize economic criteria for measuring profitability and excessive profits, to enable contractors to understand the Board's standards.

Capital employed as the measure of profitability

Using return on capital employed as a measure of profitability is widely acknowledged in the commercial sector. In the Federal Government, as a result of recommendations by the Industry Advisory Council and GAO, DOD has incorporated a rate of return on capital employed as a significant factor in negotiating profit rates.

The subjective applications of the statutory factors have provoked criticism that the Board arbitrarily leaves contractors with widely varying rates of return on capital employed. We noted that the Board's determinations left contractors with remarkably consistent returns on sales but wide-ranging returns on capital. A regional board official stated that it is a rule of thumb to leave a sales return of less than 10 percent to large contractors and between 10 and 14 percent to small contractors. We found no similar rules of thumb for returns on capital employed. The Board apparently emphasizes return on sales rather than return on capital employed as the measure of a contractor's profitability.

During our review the Board began focusing greater attention on contractors' capital employed to produce renegotiable sales. Board officials advised us that contractors would be required to report to the Board the amount of capital employed and the method for determining it. This data should provide a better basis for evaluating the reasonableness of profits earned by contractors, especially when Government-furnished capital and/or assets are used to produce some part of the sales.

We endorse the Board's effort to obtain capital-employed data from contractors. Recognizing that DOD profit

negotiation policies now consider capital employed, we urge that the Board issue guidelines to contractors for measuring capital and develop an analytical framework and criteria for relating the capital-employed factor to renegotiable business.

Use of industry averages and automatic data processing

The Board seldom uses industry averages in measuring profitability. Recognizing the need for more broadly based and objective analyses, the Chairman of the Board recently approved a proposal for adopting automatic data processing. Officials anticipate that it will enable the development of a historical data base that will encourage and facilitate comparative financial analyses.

The proposal provides for initially applying automatic data processing to the screening process. Officials plan to program into the system a set of parameters based on key financial ratios which the computer can use to identify contractors for clearances.

Guidelines could limit Statutory Board review

In 1964 the Office of Management and Budget (OMB) recommended that the regional boards be authorized to conclude renegotiation in all cases and that the Statutory Board reviews be limited to only those cases where disputable issues or questions of fact arise out of the regional board reviews. OMB further recommended that cases be returned to the regional boards for completion if the contractors submitted additional information during the Statutory Board review. In such cases, the Office of Review and the Office of Accounting would, at the request of the Statutory Board, act as technical consultants to the regional boards. The Board did not act on this recommendation.

IRS procedures basically allow a taxpayer as many appeals in its district offices and appellate division as the Board allows a contractor in its regional boards and Statutory Board. However, unless legal or factual questions are unresolved in the IRS district office, the appellate division does not become involved in a case. When questions do exist, the appellate division considers only those

specific questions; it does not make a new review as the Statutory Board does. If the taxpayer submits additional data during the appellate division's review, the data is returned to the district office for further evaluation.

We feel that the Board should revise its regulations to reflect IRS's procedures and OMB's recommendations. Although the Statutory Board makes the final decision on cases reassigned to it from the regional boards, these decisions have never been formulated into directives that would serve as a precedent for future cases. Therefore, we believe that the Board should establish formal guidelines for applying the statutory factors and for adequately documenting the weight of each factor before it considers OMB's recommendations. Such guidelines would enable reviewers to more easily assess excessive profit determinations.

AVERAGING OF PROFITS

Renegotiation is conducted not for individual contracts but for a contractor's receipts or accruals under all renegotiable contracts and subcontracts in the contractor's fiscal year. Therefore, aggregate renegotiable profits in any fiscal year will often reflect the performance of several contracts in different stages of completion, which results in offsetting losses or low profits on some contracts against higher or even excessive profits on others.

The situation is made even more complex because sales of companies under common control may be renegotiated on a consolidated basis with the same offset occurring between divisions and subsidiaries. A conglomerate corporation engaged in a variety of businesses benefits particularly from this aspect of renegotiation, since it can offset the high profits of certain divisions or subsidiaries by the losses or lower profits of other divisions or subsidiaries.

To minimize the excessive profits eliminated by averaging profits, the House Committee on Government Operations, in its December 1971 report, recommended that the act be amended to classify contractor sales according to individual commodity groupings and to base renegotiation on product line sales rather than on total company sales. Although the Board, when possible, attempts to examine renegotiable business on a product-line or division-subsidiary basis,

excessive profit determinations generally are made on an overall basis.

We noted several instances in which consolidated filings were particularly advantageous to contractors. For example, a contractor reported sales and profit figures for four affiliated companies engaged in ship repair, tug and barge charter, oceanographic instrument sales, and dredging operations as follows:

Company	Sales	Profit	Profit rate (percent)
	(000 omitted)		
A	$ 616	$ -36	-5.8
B	3,570	242	6.8
C	2,505	1,116	44.6
D	498	61	12.3
Total	$7,189	$1,383	19.2

The Board determined that the contractor's excessive profits totaled $275,000, leaving the contractor with a 16-percent profit. It seems evident that the excessive profits relate almost entirely to company C. Had the Board been required to consider company C separately, the excessive profit determination would have been substantially greater.

LOSSES CARRIED FORWARD

To compensate contractors for losses incurred on renegotiable business in previous years, the Congress has provided that a loss which is not due to gross inefficiency on the part of the contractor may, for the fiscal years ended after December 31, 1958, be carried forward to each of the 5 fiscal years after the loss year. The loss is applied to the first year after the loss year. Any remaining loss is then applied to the following year, etc., until it is fully absorbed or the carryover period expires.

APPEALS TO THE COURTS

When a contractor declines to enter into an agreement with the Board to eliminate excessive profits, the Board

issues an order directing that such profits be eliminated. Under the act, contractors have a right to petition for redetermination by the courts. In the past 6 years, about 75 percent of the Board's unilateral orders have been appealed to the courts.

The Congress transferred jurisdiction to file petitions for redetermining the Board's unilateral orders from the Tax Court to the Court of Claims, effective July 1, 1971. The reasons cited for the transfer were:

1. The subject matter of renegotiation cases is similar to matters already handled in the Court of Claims.

2. The procedures followed in the Court of Claims are believed to be better suited to renegotiation because of the volume of evidence and length of time needed to handle the cases.

3. The workload of the two courts would be equalized.

4. The two courts believe the transfer is appropriate.

The impact of the transfer cannot be effectively measured at this time because the lengths of time each court has had jurisdiction are not comparable.

The change in courts will affect cases because (1) the burden of proving the existence of excessive profits has been shifted from the contractor to the Government and (2) the Court of Claims has lengthier and costlier pretrial hearings than the Tax Court.

Proceedings before the Court of Claims are estimated to cost the contractors and the Government about twice as much as they did in the Tax Court. The first case was tried on its merits before the court, but a Board official told us that lengthy posttrial discussion would postpone final determination for a year or more. A Department of Justice official believes that, because of the transfer, more orders will be appealed. As of November 1972, 126 cases in various stages of completion were before the court. The relationship of the dollar amounts of settlements by each court with the Board's excessive profit determinations is shown in the following graph.

Percentage of Dollar Amounts of the Renegotiation Board's Determinations of Excessive Profits Upheld in the Courts

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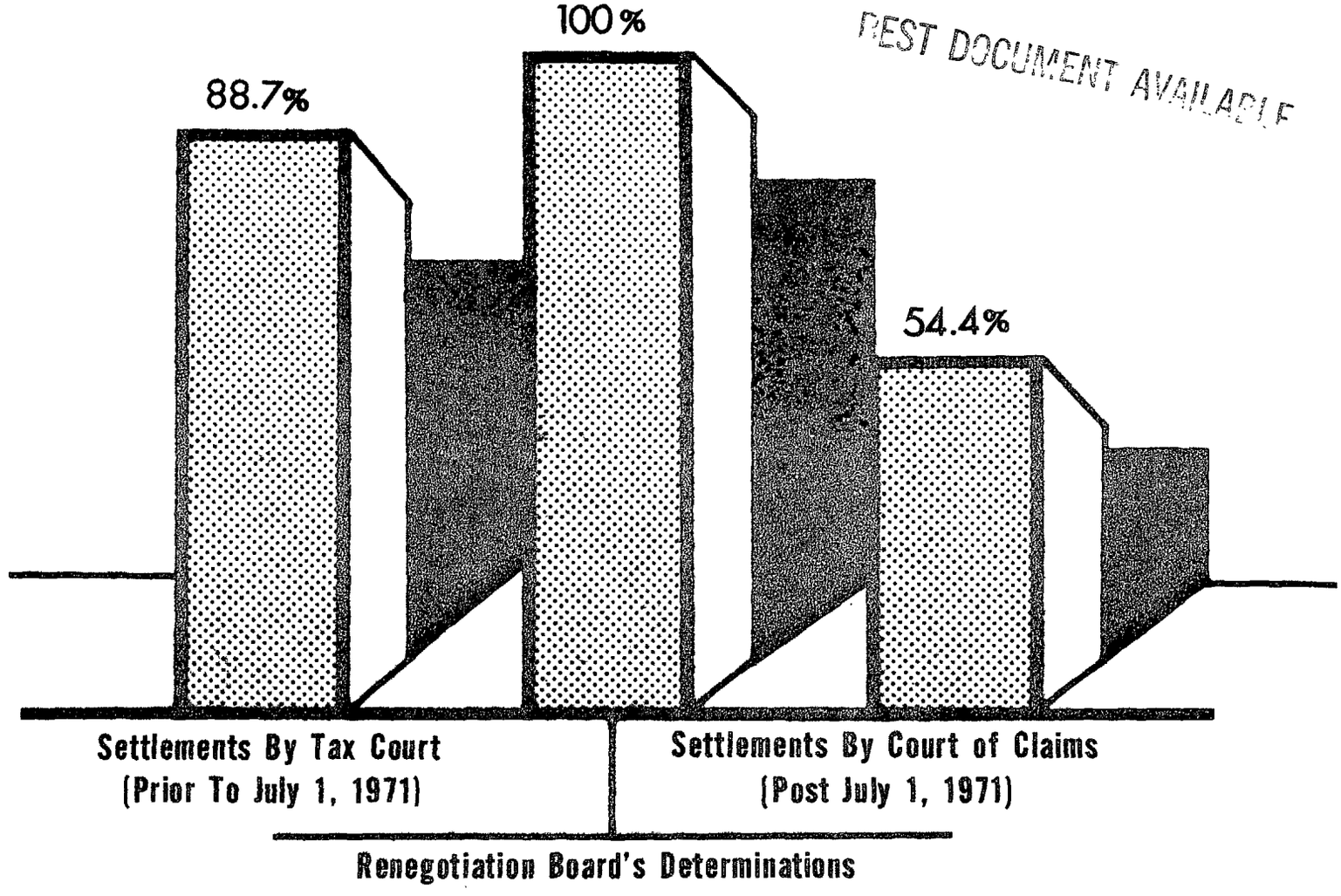

Although we did not determine the number of settlements without trial before the Tax Court, we did determine that all the settlements before the Court of Claims were without trial. We noted that one settlement before the Court of Claims reduced the Board's original determination by more than $3 million, or about 60 percent.

When an excessive profit determination is appealed to the courts, the Department of Justice is responsible for preparing and presenting the Government's case. The Department fully investigates each case because the Board's files are not admissable as evidence in the court. The Department's results may differ significantly from the Board's results. Board officials recognize that, in presenting information to Justice, specific facts and objective analyses rather than subjective considerations must support the determinations. Expert witnesses outside the Board are frequently subpoenaed to testify.

RECOMMENDATIONS

We recommend that the Board:

1. Develop guidelines to show specifically how the statutory factors are to be applied and weighted and include in files adequate documentation on the rationale for all decisions.

2. Give greater consideration to the rate of return on capital employed in producing renegotiable sales and use industry averages to provide for more objective and broader based analyses.

CHAPTER 6

COLLECTION OF EXCESSIVE PROFITS

When the Board finds that a contractor has realized excessive profits, it tries to enter into an agreement with the contractor on the amount of the excessive profits and, when appropriate, the terms of payment. If the Board and the contractor are unable to reach an agreement, the Board issues a unilateral order directing the contractor to pay the amount determined. After reaching an agreement or issuing an order, the Board directs the department having the most Government business with the contractor to collect the excessive profits or to offset amounts due the contractor under current contracts. The department's finance office closes the account upon final settlement.

The contractor may request a modification to the terms of payment before fully paying. The modification may extend the time to pay or may permit the contractor to pay by installments rather than by a lump sum. When the contractor refuses or is unable to pay or when it petitions the Court of Claims for a redetermination of the order, the case is forwarded to the Department of Justice for action.

The following table shows the gross excessive profits which the Board reported as excessive profit determinations for fiscal years 1962-72. Although the amount is net of State income tax adjustments, it does not exclude deductions of credits for Federal income tax. The actual amounts the finance offices recover for each period would be about 50 percent of the Board's gross excessive profit determinations.

Fiscal year	Excessive profit determinations		
	Gross (after State taxes)	Federal taxes	Actual amounts to be recovered
	(millions)		
1962	$ 7.8	$ 3.4	$ 4.4
1963	10.1	5.1	5.0
1964	24.2	11.9	12.3
1965	16.1	7.3	8.8
1966	24.5	11.5	13.0
1967	16.0	7.7	8.3
1968	23.1	9.8	13.3
1969	21.4	9.7	11.7
1970	33.5	14.5	19.0
1971	65.2	31.1	34.1
1972	40.2	19.4	20.8

COLLECTION OF PAYMENTS

The following table summarizes the amounts collected under the act by the Departments of the Army, Navy, and Air Force and by the Defense Supply Agency as of June 30, 1972. These agencies collect nearly all the profits determined to be excessive.

Agency	Amount collected
Army	$ 95,417,220
Navy	52,507,860
Air Force	195,873,370
Defense Supply Agency	7,290,695
Total	$351,089,145

Our review of selected accounts in the finance offices of these agencies revealed that the contractors' payments were generally on time.

CHAPTER 7

PROFILE ON FIRMS MAKING EXCESSIVE PROFITS

We analyzed the firms which made excessive profits in fiscal years 1970-72 to determine their most common characteristics. The results of our analysis are shown below.

Characteristics	Percent of total
Renegotiable profits:	
Below $800,000	65
Over $800,000	35
Renegotiable sales to total sales:	
Under 50%	25
50% to 75%	18
Over 75%	57
Total sales:	
Below $5 million	57
$5 million to $10 million	20
$10 million to $25 million	12
Over $25 million	10
Renegotiable sales:	
Below $5 million	75
$5 million to $10 million	16
$10 million to $25 million	6
Over $25 million	3
Total capital:	
Below $500,000	28
$500,000 to $1 million	20
$1 million to $5 million	34
Over $5 million	18

Our analysis showed that primarily small firms were found to have made excessive profits; they had total sales (renegotiable and nonrenegotiable) of below $10 million, renegotiable sales of below $5 million, total capital below $5 million, and the bulk of their business was with the Government. The Board rarely found the largest defense contractors to have made excessive profits. Because most of the firms were either small or medium size, the producers of major weapon systems do not seem to be the contractors making excessive profits. Rather, many of the contractors making excessive profits were producers of relatively low-technology products, such as ordnance or textile products.

BEST DOCUMENT AVAILABLE

Prime contract sales accounted for about 82 percent of the total renegotiable sales, and subcontract sales accounted for the balance. About 70 percent of the prime contract sales were under fixed-price contracts. We were unable to determine whether the excessive profits were made primarily under negotiated or formally advertised contracts. However, a law firm which represents contractors against which excessive profit determinations have been made told us that about 60 to 70 percent of its clients' renegotiable sales were under formally advertised contracts.

In part, the reason for the lack of excessive profit determinations among major defense contractors may be the averaging of profits for companies under common control. (See p. 37.) Further, many large companies produce articles or services that may be exempt from renegotiation, e.g., computers and peripheral equipment, aluminum and aluminum alloys, textile fabrics, refined petroleum products, automobile and aircraft tires, steel, semiconductors, photographic film, pharmaceuticals, and aircraft communication and navigation equipment.

NEED FOR INCREASED COORDINATION WITH DOD

The Board began forwarding data on excessive profit cases to the Office of the Assistant Secretary of Defense (Installations and Logistics) in 1968. Recently, it started providing additional data more frequently. However, it has not provided data to the individual procurement activities, primarily because most sales and excessive profit determinations are related to contracts with DOD.

A Board official told us that DOD has not found the data useful because it is not current.

Although we agree that procurement activities may not always benefit from receiving this type of data, they would benefit from knowing:

--The industries which earn exessive profits.

--The year in which the profits were earned. (The activities could decide whether volume purchases due to the Vietnam conflict were the cause of excessive profits.)

--The department which procures the goods and services.

--The types of contracts awarded and whether the pricing and award were competitive.

--The characteristics of each industry, such as capital structure, corporate structure, etc.

--The contractors' prior experience with the Government.

The procurement activities could then adjust their policies to consider:

--The type of contract to be selected in particular cases.

--Business volume fluctuations in certain industries.

--Certain prime contractors' and subcontractors' pricing data.

If many of the excessive profit determinations relate to contractors under formally advertised contracts, this should be of particular interest to procurement activities. This method of procurement is generally assumed to provide the Government with the maximum benefit of competition, e.g., reasonable prices and profits. Analysis of the advertised contracts that produced excessive profits may show that awards were made clearly without adequate competition.

CONCLUSIONS

The Board should consider forwarding data on excessive profit determination to procurement activities for their use in long-term evaluations of procurement practices and policies. The data should concern types and sizes of industries, types of products produced, types of contracts awarded, and other pertinent information. Renegotiation policy and procurement policy might then be better coordinated.

RECOMMENDATION

We recommend that the Board consider forwarding to procurement activities data on excessive profit determination and on the Board's analyses of such determinations.

CHAPTER 8

RECOMMENDATIONS OF THE PROCUREMENT COMMISSION

The Commission on Government Procurement made the following recommendations concerning renegotiation in its December 1972 report to the Congress.

--Extend the act for 5-year periods.

--Extend the act to all Government agency contracts.

--Raise the statutory floor from $1 million to $2 million for sales to the Government and from $25,000 to $50,000 for brokers' fees.

--Expand and clarify the criteria used by the Board.

We believe that, if the act is extended, it should be extended for more than 2 years. The longer period would create a feeling of permanence in the Board and thus assure Board employees that any long-range plans and proposed improvements in the Board's operations could be implemented. We believe that congressional review of the Board's activities would not be inhibited by increasing the extension periods.

We did not determine whether excessive profits occur under contracts awarded by agencies not covered by the act but it seems possible where price competition is inadequate. We therefore support the proposal to broaden the scope of renegotiation to include all Government purchases of goods and services.

We analyzed the number and amounts of excessive profit determinations made during fiscal years 1970-72 to determine the number and amounts of such determinations that would have escaped renegotiation if the floor had been raised to $2 million or $5 million. Our analysis showed that, of the 450 excessive profit determinations for $139 million, about one-third, for $13 million, would have escaped if the statutory floor had been $2 million and about two-thirds, for an estimated $46 million, would have escaped if the floor had been $5 million.

The Board recently made a study to determine the effect that raising the floor to $2 million for contractors and $50,000 for agents and brokers would have had on the number of filings received in fiscal years 1971 and 1972. The study showed that 1,796 contractors' filings would not have been received and that approximately 402 agents' and brokers' filings would not have been received.

We agree with the Commission that the Board should expand and clarify the criteria it uses to determine excessive profits. (See ch. 5.)

CHAPTER 9

AGENCY COMMENTS AND OUR EVALUATION

On April 10, 1973, the Board acknowledged receipt of a draft of this report. Although the Board indicated that it had not had sufficient time to comment in detail, it made the following general statements.

1. The GAO review of the Board's operations and activities took place when the Board itself was engaged in an intensive internal process of review and rejuvenation.

2. The Board has been aware of growing public and congressional interest in the adequacy of the renegotiation process. It has accelerated the process of internal reevaluation and has started a program which is still unfinished.

3. The Board issued an administrative letter on December 6, 1972, which provided guidelines for preparing Renegotiation Reports and Memorandums of Decision and which called for using industries' financial and other data as a touchstone for evaluating the statutory factors. The Board believed that this, as well as other actions, would greatly facilitate an early development of written guidelines for determining excessive profits.

4. The Board is developing a system to use automatic data processing techniques in renegotiation. The system will be programed so that the voluminous data--including a complete picture of the contractors' positions, financial data, and profit ratios for current and prior periods compared with industries' ratios--will be available for use in both screening and full-scale renegotiation.

The Board expressed confidence that the changes already instituted, together with changes being developed, many of which are recommended in this report, would make renegotiation a more open, more adequate, and more objective process. (The Board's complete comments are included as app. II.)

We agree that the Board has taken many constructive actions in the last few months to improve the renegotiation

process. In addition, we have outlined several other specific recommendations that we believe will contribute to consistent and uniform determinations and will give the Congress, contractors, the public, and the courts a better understanding and increased confidence in renegotiation. Our recommendations are also designed to provide greater assurance that the Board has complete and accurate information from contractors and to enable the procurement agencies to evaluate why excessive profits result from certain procurements.

CHAPTER 10

ELIMINATION OF EXCESSIVE PROFITS BY FOREIGN GOVERNMENTS

Some foreign governments also have devised methods to recover excessive profits from contractors. The United Kingdom and Canada, for example, have processes for recovering excessive profits made on Government contracts.

THE BRITISH PROCESS

In February 1968 the British Government decided that it must deal with excessive profits when there is no competitive check on agreed prices. On August 1, 1969, an independent Review Board for Government Contracts was established by an agreement between the Government and the Confederation of British Industry.

The purpose of the Review Board is to review noncompetitive, Government, risk-type contracts and subcontracts to determine whether the contractors should reimburse the Government or receive additional compensation from the Government. Both the Government and the Confederation can refer contracts to the Review Board if profits of 27-1/2 percent or more on capital employed and losses of 15 percent or more have been made. The Review Board can also review contracts within these percentages if there is evidence that prices were not fair and reasonable. Both the Government and the Confederation accept the rulings of the Review Board.

The Government and the Confederation agreed that a formula for negotiating profits for Government contracts should be designed to give contractors a fair return on capital employed; that is, an amount equal to the average of the industry's earnings for the last 7 years. The current formula provides that a 12-percent return on capital plus a 3-percent return on cost be applied to all noncompetitive, Government, risk-type contracts awarded since August 1, 1970. The Review Board is to review the profit formula every 3 years.

THE CANADIAN PROCESS

The Defense Production Act of 1951 established the Canadian process for recapturing excessive profits on defense contracts. Under the act the Department of Supply and Services audits contractors' operations every 3 to 5 years. Contractors are selected for audit and approved by the Minister according to the volume of their defense business.

The Canadian process applies only to negotiated, firm-price contracts; it does not apply to competitive contracts. Returns of between 7.5 percent and 12.5 percent of profit to cost are considered fair and reasonable. Refunds are recoverable in court, but the Government has never resorted to the courts. The Canadian Government has recovered $11 million in excessive profits since World War II.

CHAPTER 11

SCOPE OF REVIEW

In examining the Board's activities and operations, we reviewed the history of renegotiation statutes; determined, when possible, the rationale for various aspects of the act; and obtained comments on the Board's operations from people knowledgeable of the renegotiation process.

Our evaluation of the Board's practices and procedures included a determination of (1) how the Board identifies contractors and subcontractors subject to the act, (2) how cases are assigned to the regional boards, (3) the effectiveness of the regional boards' operations, (4) how the Board makes excessive profit determinations, and (5) how cases are appealed to the courts.

We also made limited examinations of the effect of transferring appeal cases from the Tax Court to the Court of Claims and the extent to which excessive profits are collected.

We were unable to determine whether the Board makes excessive profit determinations consistently and uniformly and were unable to identify the amount of sales exempt from renegotiation for each type of exemption provided for in the act.

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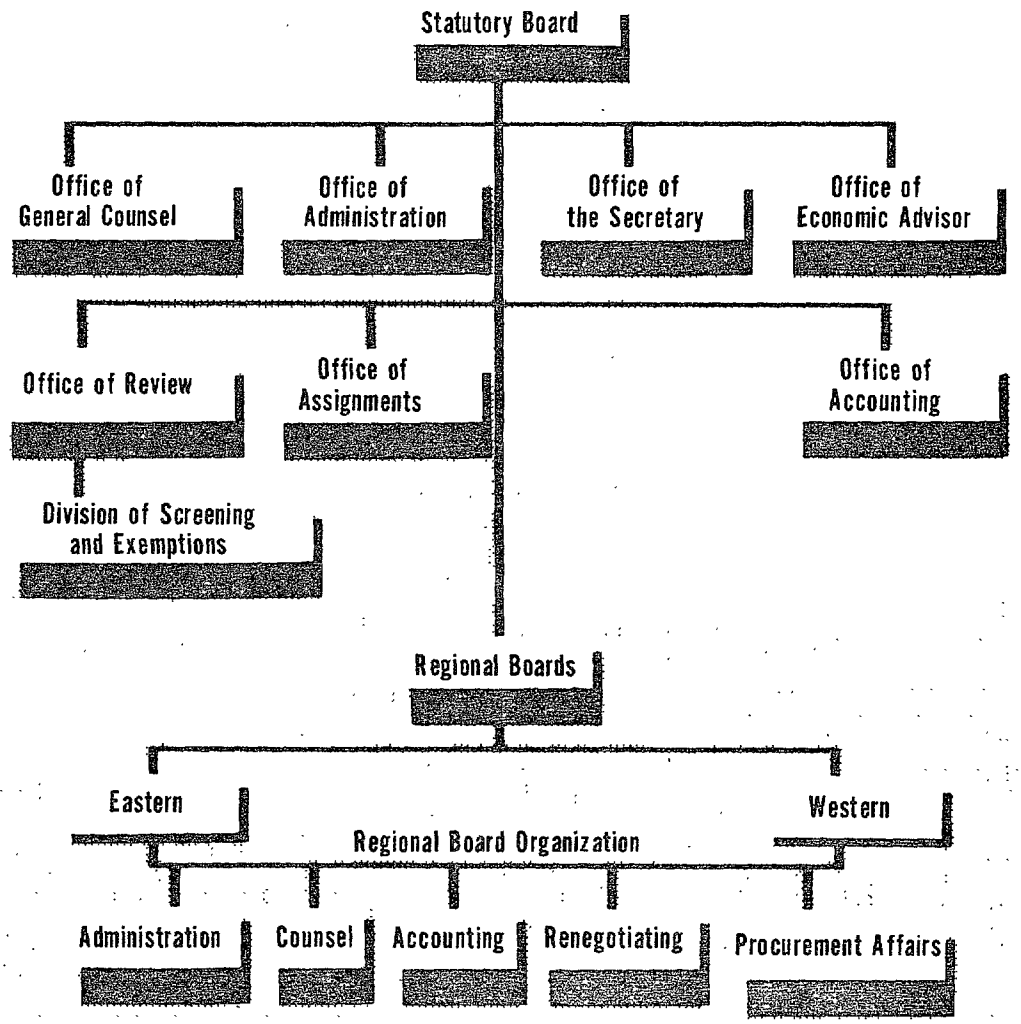
Organizational Chart of the Renegotiation Board



APPENDIX II

WASHINGTON, D.C. 20446

April 10, 1973

Honorable Elmer B. Staats
Comptroller General of the
United States
Washington, D. C. 20548

Dear Mr. Staats:

On Friday, April 6, 1973, the Board was given a copy of a revised draft of a report to the Congress of the United States entitled "Review of the Operations and Activities of the Renegotiation Board." The Board was requested to furnish any written comments it may wish to make by Tuesday, April 10, 1973. In view of the shortness of time and the fact that the draft is still being reviewed and may be subject to change, the Board cannot make detailed, technical comments or corrections. In lieu of that, the Board wishes to make the following general statement:

The GAO review of the Board operations and activities took place during a period when the Board itself was engaged in an intensive internal process of review and rejuvenation.

During the 1968 extension of the Act, public discussion of renegotiation issues intensified and congressional hearings were held in the spring of 1971.

For some time, the Board has been aware of the growing public and Congressional interest -- and concern -- in the adequacy of the renegotiation process. The Board has accelerated the process of internal reevaluation and set in motion a program which is still unfinished, but the results of which are, to some extent, evident in the GAO report.

In an effort to restore the original clarity of Congressional intent and to give strength to the statutory injunction given to the Board to "endeavor to make an agreement with the contractor or subcontractor with respect to the elimination of excessive profits received or accrued, "the Board made extensive amendments in its procedures. The Board now provides the contractor with a copy of the Renegotiation Report whenever a regional renegotiator recommends a finding of excessive profits. The Board eliminated the practice of making a "tentative determination" of excessive profits as part of the regional procedure; this should eliminate complaints that cases are prejudged by the regional boards.

A Memorandum of Decision is now provided to the contractor in clearance cases and whenever a finding of excessive profits is made by a regional board or the Statutory Board. The Memorandum of Decision sets forth the relevant facts of the case, including a discussion of all material issues of fact, law or accounting; it provides the contractor with an analysis and evaluation of his case under the statutory factors and an explanation of the judgment process that resulted in the Board's findings.

These "due process" amendments, in addition to opening up the renegotiation procedure and thus improving opportunities for reaching agreement with contractors, will also make renegotiation a more objective process.

An Administrative Letter, issued on December 6, 1972 and providing guidelines for the preparation of Renegotiation Reports and Memoranda of Decision under the new procedure, calls, among others, for the use of industry financial and other data (including ratios and percentages) as the touchstone for the evaluation process under the factors. This and other prescriptions of the Administrative Letter, combined with the openness of the process will, the Board believes, greatly facilitate an early development of written guidelines now found lacking in the renegotiation process. The publication of additional data relating to excessive profits determinations, initiated in the Board's fiscal 1972 annual report, will also be of help to the public in this respect.

The Board has taken several actions that reflect its awareness of the special problems affecting the small business contractor. A Small Business Advisor was designated to furnish advice and assistance

to small concerns who need help in understanding and discharging their responsibilities under the Act and the Board's regulations. The exemption of competitively bid construction contracts was extended to contracts awarded as a result of small business restricted advertising under small business set-aside programs. Effective contractors' fiscal years ending after December 31, 1970, the minimum refund was raised from $40,000 to $80,000 (from 10,000 to $20,000 for brokers and agents).

Since the beginning of the process in World War II, there has always been a minimum refund rule in renegotiation. The $40,000 minimum was set in 1954. In raising the figure to $80,000 in 1972 the Board took into consideration the impact of inflation and the fact that it is the small business contractor, who can least afford the time and expense involved in prolonged renegotiation proceedings, who is most often affected by a determination at or near the minimum level.

As a response to concern expressed by the House Committee on Government Operations about certain aspects of the screening process, the Board has established a special screening program for contractors appearing on the Defense Department's list of 100 companies receiving the largest dollar volume of prime contract awards. In this program, the filings of such contractors are given a more intensive review and analysis and the underlying data are verified to a much greater extent. In appropriate cases, additional data is requested of the contractor and assignment may be made to a regional office so that the data submitted by the contractor can be analyzed.

The Board is currently developing a system to use ADP techniques in renegotiation. This system will bring under automated control the voluminous data that is an inherent element of the renegotiation process. The objective of the program is to provide through computer facilities a complete picture of a contractor's position, reflecting, in addition to the contractor's own financial data, all meaningful ratios applicable to the case. Comparable data will also be provided with respect to the contractor's prior years, and with respect to other contractors active in the same or related industries and operating under the same or similar circumstances. The system will be programmed so that the data can be retrieved in any configuration for use in our screening process and in the examination and analysis of cases assigned to regional boards for full-scale renegotiation.

The Board is confident that the changes referred to above, together with changes that are currently being developed, many of which are recommended by this report, will make renegotiation a more open, more objective, and a more adequate process.

Sincerely yours,

Richard T. Burress
Chairman

APPENDIX III

PRINCIPAL OFFICIALS OF THE RENEGOTIATION BOARD

RESPONSIBLE FOR ADMINISTRATION OF THE MATTERS

DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
CHAIRMAN:		
Richard T. Burress	Nov. 1971	Present
BOARD MEMBERS:		
Lawrence E. Hartwig	Oct. 1951	Present
William S. Whitehead	June 1969	Present
Rex M. Mattingly	Aug. 1969	Present
D. Eldred Rinehart	Oct. 1969	Present

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