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GUIDELINES FOR THE SURVEY OF
CIVIL AGENCIES PROCEDURES AND PRACTICES IN NEGOTIATING
NONCOMPETITIVE CONTRACTS OVER \$100,000 AND TO EXAMINE
THE REASONABLENESS OF PRICES NEGOTIATED
CODE 950346

PROCUREMENT AND SYSTEMS ACQUISITION DIVISION
GENERAL PROCUREMENT SUBDIVISION

SEPTEMBER 1976

005182
Other

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Guidelines for the Survey of
Civil Agencies Procedures and Practices in Negotiating
Noncompetitive Contracts Over \$100,000 and to Examine
the Reasonableness of the Prices Negotiated
Code 950346

OBJECTIVE

The objective of this survey is to determine, for those contracts selected, whether sufficient bases exists to warrant performing a detailed review of the reasonableness of the price negotiated. In addition, we also want to evaluate procedural problems at the procurement office *were evaluated* when we identify instances where the price may have been over stated because of actions taken by the contracting officer or members of his team, such as the auditors or technical evaluators.

This survey will cover 25 fixed price, noncompetitive negotiated contracts over \$100,000 awarded by four major civil agencies (NASA, DOT, HEW and HUD) on the basis of certified cost or pricing data. The contracts to be examined are shown in the attached listing.

The following factors were considered in selecting the contracts:

(1) value, concentrating on the larger; (2) manpower available within our participating regional offices, a maximum of five contracts has been assigned for examination by each region; and (3) location of contractor to permit participation by the regions. The total value of the contracts to be examined is \$33.6 million.

BACKGROUND

Public Law 87-653, the Truth-in-Negotiations Act, enacted by Congress in September 1962, applies primarily to Defense procurement although its provisions have been applied to Civil agencies through the Federal Procurement Regulations (FPR). The law requires (1) prime contractors and subcontractors to submit, subject to certain exemptions, cost or pricing data (as

defined in FPR 1-3.807-3(h) in support of proposed prices for noncompetitive contracts expected to exceed \$100,000 and at the completion of negotiations, and (2) that contractors and subcontractors certify that the cost or pricing data provided is accurate, current, and complete. Refer to the FPR 1-3.807-3 for specific requirements for cost or pricing data. The Law also provides for contract price reduction when the negotiated contract price to the Government was increased by any significant sums because the contractor furnished cost or pricing data which was not complete, accurate, and current as certified in the contractor's certificate of current cost or pricing data

(FPR 1-3.814-1 Price Reduction for Defective Cost or Pricing Data). We want to emphasize, however, that rather than merely identifying and reporting potential defective pricing, we will evaluate the agencies' contracting procedures in order to identify any management weaknesses which are apt to result in other instances of overpricing unless they are corrected.

X FPR 1-3.807-2(c) provides that some form of cost analysis (financial audit and technical evaluation) of the contractor's proposal be performed whenever cost or pricing data are required (Per FPR 1-3.807-3) to be submitted. Financial audits and technical evaluations are reviews of a contractor's submitted cost or pricing data and of the judgmental factors applied in projecting from the data to the estimated costs. They provide advice to the contracting officer about the degree to which proposed costs are representative of future performance, assuming reasonable economy and efficiency.

The contracting officer is responsible for negotiating a fair and reasonable price (FPR 1-3.801-2). The degree to which adequate cost analyses and technical evaluations are performed and the extent to which such assessments are relied upon in negotiations by the contracting officer, significantly influence the contract price.

In the review of 28 Department of Defense (DOD) prime and subcontracts, which resulted from previous surveys, we found that the negotiated prices of prime and subcontracts were \$22 million higher than indicated by available cost or pricing data. The prime contract overpricing occurred primarily because (1) contracting officers did not obtain adequate cost or pricing data along with prime contractors' proposal submissions, (2) adequate cost and technical evaluations of the proposal were not performed and/or (3) negotiations with the contractor were ineffective. Subcontracts appeared to have a propensity for over and/or defective pricing primarily because (1) subcontractors were not aware of the date that the prime contractor signed the "Certificate" and did not update the subcontract proposal through that date (FPR 1-3.807.3(d)(2)), (2) of claimed ignorance by the subcontractor of the requirements of FPR 1-3.807.3 and (3) the prime contractor failed in his responsibility to update the prospective subcontractor's data to the "Certificate" date from the time of the original submission by the subcontractor. Regional Offices are required to identify individual subcontractor proposals for additional programmed survey effort where appropriate.

LOCATION OF WORK

The survey work will primarily be performed at the contractors' plants. Prior to starting work at the contractors' locations, the Regional Office should obtain from the cognizant procurement office the following information:

- prime and subcontractor's executed Certificate of Current Cost or Pricing Data, if any,
- the contract pricing proposal, (GSA optional Form 59 or 60, DD Form 633),
- all cost or price analysis reports (internal or external),

--the price negotiation memorandum,

--the complete contract.

In instances where the prime contractor is located in a different geographic area than that of the contracting office, PSAD/GP will attempt to obtain the above mentioned data from the contract office and then forward this data to the respective GAO region in order to facilitate the start of the survey.

If circumstances indicate that additional work must be performed outside of your respective GAO region, please contact PSAD/GP for coordination.

AUDIT GUIDELINES

Key indicators in achieving the stated objectives are as follows:

- A. Inadequate support for estimates in the price proposal.
- B. Inadequate Government cost and technical evaluations of cost or pricing data submissions or ineffective use of the data and evaluations in negotiations.
- C. Update price proposals not obtained or evaluated where warranted.
- D. Significant cost underruns in the performance of contract effort.

A. INADEQUATE SUPPORT FOR ESTIMATES IN THE PRICE PROPOSAL

1. Initially, we should determine the method by which the agency requires its contractors to submit their contract pricing proposals. Our preliminary work at the agencies have indicated that various forms are being used for this purpose. DOT, HEW, and HUD are all subject to the provisions of the FFR which prescribe using optional Form 59 or 60 (FFR 1-16.902) but many of these agencies have their own implementing regulations which may provide for alternatives. (Coast Guard, for instance, deals with many defense

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COPY contractors who are more familiar with the DD Form 633). NASA, being an independent agency coming under the Defense Production Act of 1950 implements NASA Procurement Regulations which prescribes the use of the DD Form 633 (NASA PR 16.202). Use of these forms provide a uniform basis to submit and identify incurred or estimated costs and contain detailed instructions to offerors concerning the use of these forms.

2. For the following cost elements, the appropriate column should be noted as to whether cost or pricing data was submitted or identified and whether it was complete or incomplete. The answers should consider all data submitted to the contracting officer or his representatives (i.e., DEAA) rather than just the initial submission. Where more than one price proposal was submitted, evaluate only the most recent proposal that was considered in the negotiation of the contract price.

<u>Cost Element</u>	<u>Final Negotiated Amount</u>	<u>Submitted Cost or Pricing Data</u>			
		<u>Complete</u>	<u>Incomplete¹</u>	<u>None¹</u>	<u>W/P No.</u>
Purchased Parts	\$ ---	\$ ---	\$ ---	\$---	---
Subcontracted Items	---	---	---	---	---
Raw Material	---	---	---	---	---
Standard Commercial Items	---	---	---	---	---
Material Overhead	---	---	---	---	---
Interdivisional Transfers	---	---	---	---	---
Direct Engineering Labor	---	---	---	---	---
Engineering Overhead	---	---	---	---	---
Direct Manufacturing Labor	---	---	---	---	---
Manufacturing Overhead	---	---	---	---	---
Other Costs	---	---	---	---	---
General and Administrative Expenses	---	---	---	---	---
Royalties	---	---	---	---	---
Federal Excise Tax	---	---	---	---	---
Total Proposed Costs	\$ ==	\$ ==	\$ ==	\$ ==	==
Percent	<u>100%</u>	<u>%²</u>	<u>%²</u>	<u>%²</u>	<u>==</u>
Lump sum reduction (if any) ³	\$ ==				
Profit	\$ ==				
Negotiated price	\$ ==				

¹ For those items where incomplete or no data was submitted, determine whether or not the audit reports or technical evaluation reports indicate that, although complete data was not submitted with the proposal, it was in fact furnished to the auditors or technical evaluators.

² Percent in relation to total proposed cost.

³ If lump sum reduction was identified to cost element, apply to each element.

The "Instructions to Offerors" on the rear side of the Contract Pricing Proposal Forms describes to the contractor the type of data required. As a Supplement, the ASPR Manual for Contract Pricing (ASPM No. 1), Chapter 2E(15 Sept 75) contains a number of detailed examples of what constitutes a complete submission or what represents enough data.

— get copy for info

It is emphasized that an audit or internal Price Analysis does not negate the responsibility for requiring submission of data. (See excerpts from B-168450, 8/5/74 below)

It should be recognized that a contractor's proposal may be considered to be complete if the bases for the estimates of all cost elements are described and supporting data is submitted or identified. The data submitted may, however, later be found to be inaccurate, incomplete, or noncurrent.

Although the contractor's proposal is considered to be complete, the data submitted by the contractor need not always be factual or verifiable. The contractor may state that the estimate is based on judgment and represent that no other pertinent information is available.

In evaluating support for subcontract costs, refer to FPR 3-807.3(d) through (e). This section requires, in certain instances that subcontract estimates be supported by a Subcontractor's Price Proposal and supporting data. In applicable cases, compliance with these requirements should be determined. (See page 11)

The following excerpts from our report "Improvements Still Needed in Negotiating Prices of Noncompetitive Contracts" (B-168450 dated August 5, 1974) are examples of cases where insufficient cost or pricing data were submitted in support of proposed or negotiated costs.

INTERNAL AUDIT OR PRICE ANALYSIS

We believe that the difference of opinion lies not so much in judgment, but in the criteria used to determine adequate submission of data. We believe that DOD relied primarily on the determinations by members of the pricing team that proposed costs appeared to be reasonable. While such determinations are unquestionably a tool which the contracting officer should use in evaluating the reasonableness of contractor's proposals, they are not a substitute for submission by the contractor of required cost or pricing data. The reports of audit and technical personnel which provide advice on the reasonableness of the contractor's proposed costs are not necessarily an authoritative record of the data which the contractor is certifying.

Materials

The Army's San Francisco Procurement Agency awarded a \$5.8 million contract for cartridge cases that included material costs of \$1.4 million. About \$1.2 million of this amount was not supported by adequate cost or pricing data. For one type of material, steel plate, the contractor identified the basis for unit cost but did not identify the basis for the quantity required. Other material costs were identified as based on standard costs, but no data was presented or identified to show how the standard costs were established or the basis for adjustment factors applied to the standard costs to arrive at proposed costs.

In its letter of May 24, 1974, (see app. III), DOD commented on this example.

DOD said that its review indicated that the data available was sufficient and in accord with policy requirements. Specifically, DOD stated that the contractor disclosed the steel plate to be used, its price per pound, the pounds required, and identified the price increases of steel since award of a predecessor contract. DOD also stated that the agency auditor took no exception to material, noting that the steel price was based on a catalog price effective on the same date identified by the contractor as the most recent steel price increase.

We agree with DOD that the above information was made available to the contracting officer. However, except for the basis of the price of steel plate, this information does not fulfill specific requirements for cost or pricing data established by ASPR and the ASPR Manual for Contract Pricing.

The material cost proposed by the contractor apparently consisted of several types of materials. Basic material costs were adjusted for spoilage and material variances. The contractor identified the quantity and price of the steel plate, but did not disclose the source of this information or data to support other material quantities, prices, and variances. The auditor, technical analyst, and price analyst furnished the contracting officer additional supporting information but did not adequately identify how the contractor determined the types and quantities of all materials proposed, the method of pricing all of the materials, or the basis for estimating spoilage and variance factors.

Some of the data furnished by these officials were contradictory. For example, as DOD states, the auditor noted that the proposed steel prices were based on catalog prices. The price analyst, however, stated that material costs were principally based on historical data and new quotations. As a result, there was no clear identification of the cost or pricing data submitted and certified by the contractor in support of the proposed price.

Subcontracts

The Air Force Electronic Systems Division awarded a contract which included a noncompetitive subcontract estimate of about \$515,000. The prime contractor supported this cost estimate with a firm quote furnished by a prospective subcontractor. The prime contractor, however, did not obtain and submit to the contracting officer, though required, subcontractor cost or pricing data to support the quote. DCAA's audit report on this proposal did not show what data, if any, had been furnished to the auditor to support the subcontractor's quote.

Labor

The Naval Electronic Systems Command awarded a \$1.1 million contract for electrical equipment shelters that included about \$146,000 for manufacturing labor costs. Although the contractor stated that the labor hours were based on prior experience, the experience data used to develop the estimate was not identified. The contractor stated that a composite labor rate was used but did not reveal how the rate was developed.

Overhead

The Army Corps of Engineers, Huntsville Division, awarded a contract for a shock test program. The contract price included overhead costs of \$260,000. Although the contractor's submission disclosed that this amount was computed by applying three overhead rates to certain direct labor costs, the

contractor did not submit data showing the basis for the rates.

General and administrative

The Defense Construction Supply Center, DSA, awarded a \$4.4 million contract for fire extinguishing foam which included \$205,000 for general and administrative costs. The proposal stated that general and administrative costs were based on projected costs for a particular year. The proposal, however, did not contain data showing how the proposed amount was computed, such as the various cost elements in the general and administrative pool or the base for allocation.

Other costs

The Naval Ordnance Systems Command awarded a \$9.8 million contract for gun mounts. This amount included other costs of about \$527,000, represented as being 6 percent of total production costs. Although the contractor explained that the rate was based on a mathematical projection of historical relationships between other costs and production costs under a specific contract, data in the records at the procurement office was not adequate to permit a reasonable understanding or reconstruction of the mathematical projection.

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For those elements not adequately identified in the price of proposal, compare with the cost of performance and preaward audit and technical evaluation results.

Refer to
Schedule
on page 6
of final
Program

B. INADEQUATE GOVERNMENT COST AND TECHNICAL EVALUATION
OF COST OR PRICING DATA SUBMISSIONS OR INEFFECTIVE
USE OF THE DATA AND EVALUATIONS IN NEGOTIATIONS

1. Evaluate the adequacy of the preaward audits of the contractor's price proposal in terms of scope and depth of coverage. FPR 3.801-3 and 3.809 contain guidance on the responsibilities of the contract auditor and other field pricing support personnel when reviewing contract pricing proposals. Obtain copies of the audit reports and review supporting working papers. The amount of audit effort expended by the audit team, degree of coverage, and any qualifications contained in either the working papers or the audit report should be considered in making this determination. Audit guidance is contained in Chapter 5 of DCAA's Contract Audit Manual (CAM). Where more than one preaward audit was performed, or where supplemental audit reports were issued, each audit should be evaluated. This step should include a determination as to whether the auditors performed an (adequate) evaluation of the forecasted business volume, which is often used to compute forecasted (proposed) indirect expense rates.
2. Note the timing of the preaward audit in relation to contract negotiations and whether restrictions or time constraints were imposed on the auditor. Determine if the audit report or results were (effectively) used by the contracting officer in prime contract negotiations.
3. Determine if preaward audits were requested and performed on major subcontract estimates (FPR 3.307.3(e)(3)) included in the prime contractor's proposal. A cursory inspection of the contractor's

proposed make or buy program (FPR 3.902) may facilitate the identification of major subcontractors. Refer to FPR 3.807-10 ⁶⁻¹⁰⁻⁶⁴ also. Evaluate the contracting officer's record of negotiation (FPR 1-3.811) to determine the extent to which subcontract audit reports were used or relied upon during prime contract negotiations.

4. Determine if postaward (defective pricing) audit of the price proposal, per FPR 1-3.807-5(c) has been performed or scheduled.

If the postaward review has been completed, evaluate the apparent adequacy of the scope of review and the information and/or data accumulated. In the summary briefly list the audit steps, by cost element, performed by the auditors in their defective pricing review and state the number of audit hours expended. Also include a brief summary of their findings and our comments on the post audit findings.

ask DOD if it ever makes post award audits of NASA's contracts. If not why not?

5. Determine if a review of the contractors' estimating system, per FPR 3.809 (c)(3) and paragraph 9-10⁴ of CAM, has been made. If so, obtain a copy of the report and determine whether the auditors gave proper consideration to indicated weaknesses in determining the scope of their preaward audit.
6. Public Law 91-379 resulted in the establishment of a Cost Accounting Standards (CAS) Board for the purpose of promulgating cost accounting standards designed to achieve uniformity and consistency in cost accounting principles. The Public Law and its implementing regulation FPR 1-3.1203 requires Defense as well as non-Defense contractors and subcontractors, as a condition of contracting, to disclose in writing (CASB Disclosure Statement), their cost accounting practices and to agree to a contract price adjustment, with interest, for any

increased costs paid to the contractor because of the contractor's failure to (1) comply with standards promulgated by the CAS Board or (2) follow consistently his disclosed cost accounting practices in pricing contract proposals and in the accumulating and reporting contract performance cost data. Fourteen (14) cost accounting standards (Nos. 401-412, 414-415) were promulgated through fiscal year 1975.

As part of this survey we should determine whether or not the agencies have implemented this regulation (FPR1-3.1203-subject to the exemptions noted in FPR 1-3.1203(a)(2)) by including cost accounting standards in their contracts. If the agency has failed to include these standards as part of their contract, inquire as to their reasons why. (wash. can ask this question for us if necessary)

ACO or PCO

7. Determine if the cognizant contract administration office performed a price/cost analysis or technical evaluation of the contractor's proposal. Analyze the results in the same format as previously discussed for contract audits. FPR 1-3.801-3(b) states the general responsibilities of field pricing support personnel.
8. Assure that all significant elements of proposed costs were reviewed and evaluated by audit or contract administration; also, note the currency of the data used in the evaluation process in relation to the timing of the review.

The following excerpts from our report "Improvements Needed in Making and in Reporting on Technical Evaluations of Noncompetitive Price Proposals" (B-168450 dated May 8, 1975) are examples when technical evaluations were considered inadequate.

CHAPTER 2

IMPROVEMENTS NEEDED IN MAKING EVALUATIONS

We examined 40 technical evaluations involving proposed direct costs of \$59.7 million. Evaluations of \$35.8 million, or 60 percent, of this total were adequately reviewed. In contrast, evaluations of \$23.9 million, or 40 percent, of the total were inadequate, even though some review work had been done. There is no assurance in these latter cases that contracting officers had sufficient information to negotiate fair and reasonable prices.

Below is a summary of the results of our review.

Proposed Direct Costs Examined

Results of review	Material	Manufac- turing labor	Engi- neering labor	Other	Total	
					Costs	Percent
	(millions)					
Adequate	\$25.9	\$ 5.1	\$2.8	\$2.0	\$35.8	60
Inadequate	<u>11.8</u>	<u>6.1</u>	<u>5.2</u>	<u>.8</u>	<u>23.9</u>	40
Total	<u>\$37.7</u>	<u>\$11.2</u>	<u>\$8.0</u>	<u>\$2.8</u>	<u>\$59.7</u>	

Evaluations were considered inadequate when (1) required reviews of cost or pricing data were not made and evaluators used less appropriate evaluation techniques, (2) portions of cost or pricing data were not reviewed, and (3) insufficient analyses were made.

USE OF INAPPROPRIATE TECHNIQUES

DOD regulations provide that cost analysis be made when cost or pricing data is required to be submitted. They define cost analysis as the review and evaluation of such data. In 18 cases, evaluators did not review cost or pricing data supporting all or some cost estimates. Instead they evaluated the estimates by (1) comparing them with estimates submitted for prior procurements or independent Government cost estimates or (2) using personal judgment based on claimed familiarity with the tasks to be performed, contractor's operations, or product or service to be provided. Although these techniques are acceptable as a supplement to cost analysis, they should not be used as a substitute for DOD's required review of cost or pricing data.

For example, a contractor submitted a proposal to expand the capability of a multipurpose automatic inspection and diagnostic system for automotive engines and transmissions to include another type of engine. The contractor quoted a price but did not submit any cost or pricing data. The evaluator then developed an independent estimate without benefit of the contractor's data. Subsequently, the contractor submitted a detailed price proposal totaling \$221,073 supported by cost and pricing data. The evaluator's review of the detailed proposal involved only comparing the contractor's price with his own estimate, which was similar, and did not include a review of the cost and pricing data.

However, our examination of the contractor's proposal showed that the proposed direct engineering labor hours were about 15 percent higher than those included in the Government estimate. The evaluator, in his report, did not mention the difference in direct labor hours but stated only that the proposed price compared favorably with the Government estimate.

PORTIONS OF COST OR
PRICING DATA NOT REVIEWED

DOD regulations state that the contracting officer will initiate requests for pricing assistance and will clearly stipulate specific areas of the proposal for which assistance is required. If cost analysis is requested, DOD regulations state that it will be a review and evaluation of the contractor's cost or pricing data and of the judgmental factors applied in projecting from the data to the estimated costs.

The Defense Supply Agency and an Air Force headquarters command have published procedures for assigning responsibility for determining the need for technical review and the specific proposal areas to be covered by such a review. Purchasing and project offices and Navy activities included in our review had no such procedures issued by a headquarters command although some local activities had developed some procedures.

The procedures issued by the Defense Supply Agency and the Air Force state that price analysts or administrative contracting officers are responsible for determining the need for technical review and areas to be reviewed. The technical evaluator's review, therefore, should be responsive to the requestor's instructions. The procedures also state that the administrative contracting officer or price analyst is the focal point for coordinating all pricing assistance work. Therefore, if an evaluator believes that all requested coverage cannot be provided, the reasons should be discussed with the requestor, documented in the evaluation file, and mentioned in the evaluation report.

In 20 cases, technical evaluators did not review some portions of the contractor's cost or pricing data although requested to do so. Incomplete evaluations included (1) not analyzing some cost categories, (2) not reviewing accuracy and applicability of historical data included as part of cost or pricing data, and (3) not reviewing the basis for labor hour standards, adjustments to standards, or some percentage factors used by contractors in formulating estimates.

For example, a contractor included 51,280 labor hours, at a proposed cost of \$221,016, for assembly and reliability burn-in testing as part of a proposal for improving radar altimeter systems. The price analyst requested evaluation of these hours, but no analysis was made. The need to perform other workload requirements was cited by officials of the evaluating activity as the probable reason for nonperformance. However, agreement to limit the evaluation was not obtained from the price analyst, and the evaluation report did not mention that the hours were not reviewed.

INSUFFICIENT ANALYSIS MADE

If insufficient analysis is made, the evaluator may not be able to develop sufficient data to make meaningful recommendations on the reasonableness of estimates, and the contracting officer may only have limited information for negotiating a fair and reasonable contract price. In 11 cases, evaluators made insufficient analyses when they based their recommendations on reviews of incomplete cost or pricing data and/or inadequate sample results.

Evaluating incomplete cost or pricing data

If an evaluator does not get the data used by the contractor in developing estimates, he is handicapped in making a thorough and effective evaluation. For six cases, evaluators' recommendations were based on reviews of incomplete cost or pricing data.

Inadequate samples

Contractors often submit detailed lists of items as support for proposed direct materials. Some of these lists are very long, and reviewing all the items would be time-consuming. Consequently, the use of sampling is justified.

Many types of samples can generally be classified as either judgment or probability samples. The usual goal of any sample is that it be representative of the entire group of items about which information is desired. Judgment samples are based on subjective methods of sample selection, using personal judgment, and often do not provide assurance that the sample is representative of the entire group. Probability samples are based on a body of accepted theory which makes it possible to measure the reliability of sample results.

For six cases, evaluators used judgment samples when evaluating direct materials. In our view, the methods of selecting the sample did not provide assurance that sample results represented total items being evaluated. For example, an evaluator was asked to review direct materials supported by a detailed bill of materials having a proposed cost of about \$5.2 million. The bill of materials was voluminous. The evaluator had no documentation showing how he reviewed materials. He told us his method was to scan the list until he found an item he was familiar with, then to check the listed quantity of that item for accuracy. This method of sampling provided little assurance that the bill of materials was reasonable.

CHAPTER 3

MORE INFORMATION NEEDED IN EVALUATION REPORTS

Technical evaluations are made to help the contracting officer establish a price objective to be used in negotiating the contract price. Many evaluation reports should contain more information.

Our August 1974 report to the Congress 1/ stated that many technical evaluation reports did not adequately describe the scope and depth of work performed, and specific data analyzed nor cite sufficient data and rationale to support exceptions taken to the proposal.

In our current review, we also found that many reports did not contain adequate information to support recommendations for acceptance and nonacceptance of proposed amounts. Consequently, contracting officers did not have assurance that evaluators' recommendations of acceptance or nonacceptance of proposed costs were well-founded.

For example, a contractor proposed the use of 20,525 engineering labor hours, at an estimated cost of \$146,998 to perform 50 tasks to provide items of ground support equipment. The proposal was to definitize the price for a previously issued unpriced order, and production was underway at the time the proposal was evaluated.

Reporting was inadequate for a large portion of the accepted hours because the scope and depth of work performed or the specific data analyzed were not adequately described. It was also inadequate for most of the hours not accepted because the recommendation for nonacceptance was not properly supported.

After price negotiations, but before it approved the negotiated price, a DCAS board of review analyzed the contract negotiator's price negotiation memorandum and all advisory reports, including the technical evaluation report. The board recommended that the administrative contracting officer make no award until he obtained a favorable reevaluation by the board. The board stated that the negotiation memorandum contained no information justifying the reasonableness of the negotiated price and that one reason it questioned the negotiations was because of inadequacies in the technical evaluation report. It was further stated that the report presented no firm conclusions on most labor categories because the basis

1/Improvements Still Needed in Negotiating Prices of Noncompetitive Contracts Over \$100,000 (B-168450).

for judgmental conclusions and assumptions was not adequately explained, rationale used was unclear or incomplete, and how the evaluation was accomplished was not explained. The evaluators who prepared the report told us that, in their opinion, the deficiencies in reporting occurred because of lack of training and experience.

Our August 1974 report (see p. 8) recommended that the Secretary of Defense require that activities making technical evaluations of price proposals include in their reports the scope of the evaluations, data analyzed, and data and rationale supporting conclusions and recommendations. In their comments, DOD officials stated that our recommendation would be referred to the military services and to the Defense Supply Agency as an example of a matter of concern in their effort to improve the procurement process within their organizations.

Although the evaluations we examined during this review preceded this promised action, we believe our current identification of deficiencies in the reporting process confirms the need for action by the Secretary (see p. 14).

CHAPTER 4

REASONS FOR DEFICIENCIES IN EVALUATING AND REPORTING

Deficiencies in evaluating and reporting occurred because (1) DOD had no uniform standards for these functions, (2) planning was often ineffective, (3) supervisory reviews were often inadequate, and (4) many evaluations were made by evaluators who had not been formally trained for such work.

NO UNIFORM STANDARDS

Standards are general measures of the quality and adequacy of work. Technical evaluations are made by many activities, but DOD has not developed uniform performance and reporting standards. Some individual activities had some published standards, but these varied between individual activities or agencies. This absence of uniform standards contributes to variations in the quality of evaluations.

The Armed Services Procurement Regulation Manual for Contract Pricing is available for use by all DOD activities, but it does not contain cost analysis standards. Five of the activities in our review, either purchasing or project offices, made evaluations without the benefit of published standards. The remaining 15 activities had published standards issued by local activities, agency regional offices, and/or headquarters commands.

INEFFECTIVE PLANNING

Training guides used by the Navy and the Defense Supply Agency for instructing technical evaluators in cost analyzing state that evaluators should develop a plan of action after reviewing the contractor's proposal and before visiting the contractor site. Also, during the previsit phase of a review, evaluators should coordinate with other members of the pricing team to obtain information and advice that could be of value in planning work.

The training guides do not stipulate that action plans be written. We believe, however, that listing action steps is desirable because it will facilitate control over the work and create a permanent record of the evaluation coverage for supervisory personnel to use in insuring that an adequate evaluation was made. Our review showed that few evaluators developed systematic written work plans and that many did not coordinate with other members of the pricing team.

Developing systematic analysis plans

A systematic approach to planning for an evaluation should involve a preliminary review of the proposal to be evaluated and development of an action plan before initiating detailed work. However, in only two cases was a systematic written analysis plan prepared. Evaluators told us that work steps were generally formulated mentally on a continuing basis during the course of evaluation.

Coordination with other members of the pricing team

DOD regulations state that making a cost analysis should be a team effort. The team includes contracting officers, price analysts, cost auditors, and technical evaluators. Each member is a specialist in his area of responsibility, and technical evaluators should coordinate with other members to develop information that would be useful in planning work.

Other team members may be able to provide (1) previous technical evaluation and price analyst reports and proposals for like or similar items to those included in the proposal being evaluated, (2) information on the reliability or weaknesses in a contractor's estimating system, and (3) historical data obtained from a contractor's records. This information can be valuable to an evaluator in planning work because it may provide information on how a prior evaluation was made, areas in which a contractor may have developed unsupportable estimates, and previous cost or production data for like items. In many instances, evaluators did not coordinate with other members of the pricing team to obtain this kind of information.

INADEQUATE SUPERVISORY REVIEWS

The Defense Supply Agency recognized the need for supervisory review to insure an acceptable level of performance. Its published procedures require that supervisors review the evaluation report to insure that it contains sufficient information to support recommendations and that the technical analyst has made an examination of sufficient depth. Supervisors are also required to review supporting data developed by evaluators to insure that there is a complete documentation trail. We found that evaluators generally developed limited or no documentation for work done and to support report recommendations. Activities, other than DSA offices, in our review had no procedures detailing supervisor responsibility for reviewing technical evaluation work.

We found that, regardless of whether an activity did or did not have procedures covering supervisory reviews, most such reviews were cursory and did not always insure that acceptable levels of work were done.

In six cases, supervisors did not exercise any review function. Also, in 31 cases, supervisors did not review evaluators' supporting documentations to insure that report recommendations were supported.

MANY EVALUATORS NOT TRAINED

Technical evaluations should be made by adequately trained, proficient evaluators. Only recently, however, has DOD developed courses specifically designed to provide needed training. In April 1973 the Defense Supply Agency developed such a training course and distributed it to its 11 regions, but as of June 1974, only 4 regions had given the course. One region conducted a 40-hour training session and the other three conducted formal 2-day briefings for new employees.

The Navy also developed a course, entitled, "An Introduction to Direct Cost Analysis," that was initially conducted in 1973. As of February 1974, the course had been given to 75 technical personnel, and it was expected that it would be given to 144 additional personnel by the end of calendar year 1974. The other military services have no formal courses for training technical personnel in price evaluating.

C. UPDATED PRICE PROPOSALS NOT OBTAINED
OR EVALUATED WHERE WARRANTED

1. Determine if significant changes were made in the scope of work prior to the negotiation of the contract, (

Ascertain whether the changes resulted in a revised price proposal and whether the cognizant procurement agency recognized the need for an evaluation of the updated proposal.

2. Determine whether there were significant delays in the negotiation of the contract price in relation to the dates the proposal was submitted or evaluated. An updated cost proposal may have been appropriate.

D. SIGNIFICANT COST UNDERRUNS IN THE
PERFORMANCE OF CONTRACT EFFORT

1. Where the contract effort is complete or substantially complete, compare the cost of performance with the negotiated cost. Consider any underruns in excess of 5 percent or \$100,^{50,000}000 as significant. Identify the cost elements in which the underrun exists. Where significant changes have been negotiated to the contract, attempt to relate the cost of performance to the effort negotiated for the specific procurement under review. Otherwise include all priced changes to the original contract in determining total negotiated costs. If costs were not negotiated by element, estimates will have to be made on the basis of proposed costs and profit and the price negotiated.
2. If the contract effort is not substantially complete, obtain an estimate to complete. Where this data is not available, estimate the cost of performance from the contractor's accounting system using (1) the number of items completed or delivered, (2) cost of sales or cost input, and (3) work in process inventory considerations.
3. Where the contractor does not record costs by contract, but rather uses a parts-cost or product-line cost system not compatible with the end items being produced under the contract, make a selective test at whatever costing level is comparable with the contractor's cost proposal. For example, compare the material prices for selected high value items with actual purchase history. Compare the average labor hours experienced in the production of major assemblies with the amounts proposed.

4. In order to find significant differences (in excess of 5 percent), plant-wide or departmental labor and indirect expense rates experienced during the period should be compared with the rates proposed by the contractor. Also compare the amounts upon which the proposed rates were based (calculated) with the amounts experienced during the respective period(s).
5. Correlate the cost of performance results with other potential weaknesses identified during the survey. For example, significant underruns in labor hours may be associated with an inadequate preaward audit or technical evaluations of proposed labor hours. Also, the estimating bases for labor hours may not have been adequately identified in the cost proposal.
6. If the time permits, perform a detailed comparison of the proposed and actual quantities (units, hours etc.) and cost of significant component items (such as individual direct material purchases, certain direct labor categories or functions, etc.) of the direct cost elements. This can be done to find possible defective pricing which may not otherwise be apparent and/or to decrease or increase the probability of defective pricing when significant underruns exist in the cost element totals.

It should be noted that the existence of a significant cost overrun(s) does not preclude the possibility of significant defective pricing. Defective pricing pertains to the contractor's nondisclosure of all current, accurate and complete cost or pricing data as of the date that the negotiated price was agreed to.

IDENTIFICATION OF MAJOR SUBCONTRACTS FOR SEPARATE SURVEY

Regional offices should identify major subcontracts (\$1,000,000 or more, or both more than \$100,000 and more than 10 percent of the prime contractor's proposed contract price) where subcontractor cost or pricing data was required. Such subcontracts are sometimes mentioned in the purchasing office price negotiation memorandum (PNM). Refer to FPR 1-3.807-10 and 1-3.902 for ways to facilitate the identification of major subcontractors. The amount for the subcontract included in the prime contractor's submission is the amount that should be used in determining whether the subcontract meets the above dollar criteria. Refer to FPR 1-3.807-1(b) and 1-3.807-3(b)(1) for additional criteria for the identification of major subcontractors for separate pricing survey and for the requirements for subcontractor cost or pricing data. Ascertain that the appropriate price adjustment clauses FPR 1-3.814-1 were included in both the prime and subcontract. Ascertain if a "Certificate of Current Cost or Pricing Data" was executed by the subcontractor(s).

Because the subcontractor to be surveyed may not be within the geographical cognizance of the regional office, which is surveying the prime contract, the following pertinent documentation about the particular subcontract, should be sent to PSAD/GP for programming and transmission to the cognizant regional office:

- See also
encls 2-6
FPR 1-3.807-10*
1. Prime and subcontractor's executed Certificate of Current Cost or Pricing Data, if any.
 2. Entire subcontractor's contract pricing proposal GSA optional Form 59 or 60 or DD Form 633) and supporting schedules, etc.)
 3. Purchasing office, administrative contracting office, and prime contractor cost or price analyses reports.

4. Purchasing office price negotiation memorandum (PNN) on the prime contract and the prime contractor's PNN on the subcontract if applicable.
5. Complete subcontract or purchase order.

REPORTING

*INDEXED **
A referenced survey report should be submitted to the Deputy Director, PSAD/GP at the completion of the assignment. Each contract award should be written up separately with conclusions and recommendations concerning the bases for performing a detailed examination of the price proposal. The survey summary shall include the information requested for the major subcontracts. A Form 100 should be prepared for each prime contractor location where an audit is warranted and the regional office has sufficient resources to complete the examination by ^{DEC} ~~July~~ 1977. The Form 100 should accompany the survey report.

If more prime contract review candidates are identified in the survey than can be completed within the prescribed period, Form 100's should only be prepared for those contracts with the most significant indicators of potential overpricing. The other contracts should be reviewed at a later date at the discretion of the regional office. If this occurs, contact PSAD/GP prior to making your final decision.

ADMINISTRATIVE

Bi-weekly progress reports should be submitted to the Deputy Director, PSAD/GP. Questions concerning this survey should be referred to either Paul L. Jones on 202-382-1546 or Richard P. Roscoe on 202-382-1577.

All regions should contact PSAD/GP at the start of work at each location.

* if we decide to issue a letter report on a contract, we may want to reference it.

ATLANTA REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Huntsville, Alabama	51-NAS-7-846	\$3,000,000	Space Vehicles	Goddard Space Flight Center Greenbelt, Maryland	Thiokol Corporation
Ft. Lauderdale, Florida	24-NAS-4-2317	327,332	Electrical Components	Flight Research Center Edwards, California	System Engineering Laboratories
Cape Canaveral, Florida	76-NAS-10-8972	319,000	R&D Study	John F. Kennedy Space Flight Center Cape Canaveral, Florida	International Business Machines

724-6000

\$3,646,332

CHICAGO REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Fort Wayne, Indiana	51-NAS-5-22497	\$2,129,700	Space vehicles	Goddard Space Flight Center Greenbelt, Maryland	International Telephone and Telegraph-Aero- space Optical
St. Paul, Minnesota	FA-75-WA-3624	2,400,000	Navigational Equipment	FAA - Contracts Division Washington, D.C.	Sperry-Rand Corporation
Minneapolis, Minnesota	FA-76-WA-3768	3,870,000	Miscellaneous Supply	FAA - Contracts Division Washington, D.C.	Honeywell Incorporated
Northbrook, Illinois	NIH-75-C-666	585,000	Scanner System	National Institute of Health Procurement Branch MM, DAS/NIH. Washington, D.C.	Emitronics Incorporated
Downers Grove Illinois	263-75-0077	200,000	Maintenance and Repair Services	National Institute of Health Procurement Branch MM, DAS/NIH Washington, D.C.	Packard Instru- ment Company

\$9,184,700

DALLAS REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Dallas, Texas	FA-75-WA-3566 Modification - 3	\$8,057,869	Radio, Navigational Equipment	FAA-Contracts Division Washington, D.C.	Texas Instruments
Progreso, Texas	CG-41428-A	1,738,469	Radio, T.V. Equipment	U.S. Coast Guard Washington, D.C.	Collins Radio
New Orleans, Louisiana	CG-8-6665	250,000	Pollution Control	Eighth Coast Guard District Customhouse New Orleans, Louisiana	Browning-Ferris Industries

\$10,046,338

ATTACHMENT

DENVER REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Denver, Colorado	62-NAS-8-31665	\$1,300,000	Space vehicles	Marshall Space Flight Center Huntsville, Alabama	Martin Marietta Corporation
Gallup, New Mexico	245-76-0094	327,513	Remodel obstet- rical suite	Indian Health Service Window Rock, Arizona	Navajo Housing and Development
Denver, Colorado	263-76-0373	300,755	Serum and saline solution	National Institute of Health Procurement Division, MM, DAS/NIH Washington, D.C.	Colorado Serum Company
Sante Fe, New Mexico	245-76-0068	170,000	Clinical and Health Service	Indian Health Service Window Rock, Arizona	Presbyterian Medical Services

\$2,098,268

DETROIT REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Detroit, Michigan	(FY-75) H-3837	\$1,579,610	Profile package	Housing, Urban Development Washington, D.C.	R. L. Polk and Company
Albion, Michigan	FA-75-AC-5504	699,793	Radio, T.V. Equipment	FAA Aeronautical Center Oklahoma City, Oklahoma	Corning Glass Works
Midland Michigan	9200-75-00415	371,790	VT PL Module	Center for Disease Control Atlanta, Georgia	Dow Chemical Company

\$2,651,193

ATTACHMENT

PHILADELPHIA REGIONAL OFFICE

<u>Contractor Location: City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Wilmington, Delaware	NIH-75-C-120CC	\$2,975,000	Adriamycin	National Institute of Health Procurement Branch, MM DAS/NIH Washington, D.C.	Adria Labora- tories Incor- porated
Philadelphia, Pennsylvania	(FY 75) H-3720	\$1,041,320	Fiscal agent	Housing, Urban Development Federal Insurance Adminis- tration Washington, D.C.	Insurance Company of North America
Easton, Pennsylvania	FA-75-AC-5559	433,125	Electronic Equipment	FAA-Aeronautical Center Oklahoma City, Oklahoma	International Telephone and Telegraph
Ambler, Pennsylvania	1282-75-00453	183,950	Subscriptions	Health, Education and Welfare Health Services Adminis- tration Rockville, Maryland	I M S America LTD.

\$4,633,395

SEATTLE REGIONAL OFFICE

<u>Contractor Location; City & State</u>	<u>Contract Number</u>	<u>Dollar Value</u>	<u>Type of Procurement</u>	<u>Purchasing (Reporting) Office</u>	<u>Name of Contractor</u>
Lynwood, Washington	62-NAS-8-31722	\$ 649,919	R&D Hardware	Marshall Space Flight Huntsville, Alabama	ELDEC Corporation
Warrenton, Oregon	CG-13-5775	117,608	Miscellaneous Construction	Thirteenth Coast Guard Seattle, Washington	Port of Astoria
Seattle	248-76-0183	546,668	General Health Care	Indian Health Service Portland, Oregon	Seattle Indian Health Board

\$1,314,195