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The Honorable James L. Buckley
United States Senate

74-0199

Dear Senator Buckley:

On January 30, 1974, you asked that we consider a complaint to you from Mr. Molla, President, Molla Incorporated, and provide you with our findings and views. Specifically, Mr. Molla complained that the Renegotiation Act requires an endless amount of detailed bookkeeping, filing, and maintaining of reports, and he provided examples. He also stated that the Renegotiation Board (1) identifies the refunds it obtains only in gross figures and does not disclose the net amounts recovered, (2) does not submit figures on what it costs industry to comply with its regulations and Mr. Molla feels these costs are astronomical, and (3) does not make apparent the burden it places on other Government agencies.

Mr. Molla requested that you consider (1) having the Congress revise and update the law so that it is consistent with the original meaning and intent, (2) asking GAO to review to determine whether renegotiation is cost effective, and (3) permitting the act to expire June 30, 1974.

On May 9, 1973, we completed a review of the operations and activities of the Renegotiation Board and a copy of our report to the Congress is enclosed. In that report we made a number of recommendations to the Congress and the Renegotiation Board to improve the operation and effectiveness of the Board. In addition, the Government Activities Subcommittee of the House Committee on Government Operations reviewed the operations of the Renegotiation Board and proposed many changes in the Renegotiation Act and the Board's operations in the Committee's report dated December 16, 1971. Further, the Commission on Government Procurement made four recommendations with respect to renegotiation. These are discussed on pages 47 and 48 of the GAO report mentioned above.

Our comments on Mr. Molla's specific complaints follow.

We talked with Renegotiation Board officials about the type of situation Mr. Molla described in his examples of the minute detail required by the Renegotiation Act regulations. These officials told us that a difference in color of chairs would not ordinarily make a nonrenegotiable item renegotiable (see Renegotiation Regulations 1467.47). However, the blue and brown chairs may have been purchased by the General Services Administration for stock and, as such, were

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exempt from renegotiation under the exemption for contracts which do not have a direct and immediate connection with the national defense. The red and green chairs which Mr. Molla believes are renegotiable were probably purchased under Federal Supply Schedule contracts or directly by a military department. These sales may also be exempt under the standard commercial item exemption.

We believe it highly desirable for Mr. Molla to discuss his situation and related recordkeeping requirements with the Renegotiation Board. The Board is anxious to assist contractors in avoiding unnecessary expense that may result from incomplete understanding of requirements or available exemptions.

Mr. Molla's second example is correct to the extent that sales to the State Department as well as to most other Government agencies are not subject to renegotiation whereas sales to the military departments are. However, as indicated previously, the products being sold by Molla, Inc., may qualify for the commercial item exemption. Sales to Government agencies not named in or designated pursuant to the act are not subject to renegotiation, but such sales are included in the commercial sales base to determine whether all sales of the product qualify for the commercial item exemption.

We reviewed available public information to determine whether the Board identifies only gross refunds and does "not reflect the net which in many cases would reduce the figure as much as 75 percent." We found that, although the Board does not show annual net recoveries in its annual reports, it does show the aggregate net amount after deduction of Federal income taxes from inception of the Renegotiation Act to the date of the annual report.

Also, we found that the Board set out annual net amount figures in its February 17, 1972, presentation (contained in the hearing record) to the Subcommittee on Housing and Urban Development-Space-Science-Veterans of the House Committee on Appropriations. The amount of gross excessive profit determinations and the net recoveries were shown for each of fiscal years 1961 through 1971. From the data for that period, we compute that net recoveries amount to about 53 percent of gross determinations. The difference is mainly accounted for by the related Federal income tax that is deducted from the excessive profit determination in each case so that a company required to make a refund of excessive profits can avoid the paperwork and costs of applying for a Federal tax refund.

Mr. Molla suggests that the Board justifies its existence on the basis of refunds it has procured from industry. While this may appear to be in part correct, one of the supporters of the 1951 act, Mr. Carl

Vinson, in testimony before the House Ways and Means Committee in August 1950, stated: "Renegotiation is not a revenue measure. * * * The objective of renegotiation is not to raise revenue but to hold prices down." Other Government officials have indicated their belief that the existence of renegotiation prevents excessive profits by inducing contractors to price more closely. If these views are accepted, then an important justification for the Board's existence is the avoidance, rather than the recovery, of excessive profits. Unfortunately, the amount of excessive profit avoided cannot be measured.

Our examination indicates that Mr. Molla is correct in stating that the Board does not submit figures of the cost to industry for compliance with its regulations. There is no doubt that contractors incur costs in recordkeeping to comply with the Renegotiation Act. However, we know of no information readily available that would disclose the amount involved.

We are currently completing additional reviews that relate to renegotiation. We will furnish you with copies of the reports when they are issued. In our future reviews of the Board, we will consider the feasibility of determining the cost effectiveness of renegotiation.

If we can be of further assistance, please call upon us.

Sincerely yours,



[Deputy] Comptroller General
of the United States

Enclosure