



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

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RELEASED

Dear Mr. Speaker:

In our review of insurance costs incurred by four major contractors during 5-year periods ended in 1961, we found that the Government incurred unnecessary costs of about \$1,237,500 because the military services required these contractors to bear the risk of loss or damage to certain Government-owned parts, materials, inventories, work in process, and special tooling in their possession under fixed-price contracts. We estimate that prices negotiated with these contractors for fixed-price contracts included costs for insurance and related profit, totaling about \$1,250,000, that could have been avoided if the military services had followed the Government's established policy of self-insurance. During the 5-year periods, the amounts received by the contractors for losses on this property totaled only \$12,500. At another major contractor's plant, the Government assumed the risk of loss or damage to such property in the possession of the contractor and, as a result, avoided costs of about \$295,800 during a comparable 5-year period.

It is an established policy of long standing that the Government will bear the risk of loss or damage to its property. This policy is based on the theory that the magnitude of the Government's resources makes it more advantageous for the Government to assume its own risks rather than to insure them through private insurers at rates sufficient to pay all losses and operating expenses together with a profit for the insurer. In consonance with this policy, the Armed Services Procurement Regulation provides, generally, that the Government will bear the risk of loss or damage to its property which has been furnished to contractors under either fixed-price or cost-type contracts. The Armed Services Procurement Regulation provides also that, under cost-type contracts, the Government will acquire title to all contractor-acquired property purchased for or chargeable to the contracts and will assume the risk of loss or damage to this property. Under negotiated fixed-price contracts, although the Government obtains title to certain parts, materials, inventories, work in process, and special tooling where such contracts

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provide for progress payments by the Government during contract performance, the progress payments clauses provide that, unless the Government expressly assumes the risk of loss of property to which it has acquired title pursuant to these clauses, the contractor shall bear the risk of loss or damage to such property before its delivery to and acceptance by the Government. Consequently, at a contractor's plant, the Government may assume the risk of loss or damage to certain property to which it has title although the contractor may be responsible for loss or damage to other property to which the Government also has title. The Armed Services Procurement Regulation states that because of problems of administering the contract, especially those connected with property responsibility and inventory control, the risk of loss on property to which the Government holds title because of progress payments must be on the contractor to the same extent that it would be if the contractor held title to the property.

In commenting on our findings, the Acting Deputy Assistant Secretary of Defense (Procurement) stated that he recognized the possible savings at which our report was directed but that these potential savings could not be evaluated without considering the significant services, such as inspection, safety, investigative, claims adjusting, and legal services, provided by insurers and funded out of premiums. Also, he believed that the facts of our report alone did not sufficiently support a recommendation for altering existing policy and assuming the risk of loss for property to which the Government has title pursuant to a progress payment clause in a negotiated fixed-price contract. He believed, however, that it would be useful to reexamine Department of Defense insurance policies with respect to the criteria for utilizing Government assumption of risk or private insurance.

We believe that, generally, the Government should bear the risk of loss on parts, materials, inventories, work in process, and special tooling held by contractors under negotiated fixed-price contracts where the Government has obtained title to these items pursuant to progress payments clauses in the contracts. We are recommending that the Secretary of Defense take action to provide for Government assumption of risk of loss or damage to all Government-owned property of this type in the possession of contractors under negotiated fixed-price contracts unless, in

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individual cases, contracting officials can show that assumption by the contractor of the risk of loss on such property is less costly to the Government. We are recommending also that when the Government bears the risk of loss on this property, the contractor be required to represent that no costs for insurance on such property are included in the prices established for negotiated fixed-price contracts.

This report is also being sent today to the President pro tempore of the Senate. Copies are being sent to the President of the United States, the Secretary of Defense, and the Secretaries of the Army, Navy, and Air Force.

Sincerely yours,

JOSEPH CAMPBELL

Comptroller General
of the United States

The Honorable John W. McCormack
Speaker of the House of Representatives