DEPARTMENT OF DEFENSE

AUDIT REPORT

JUSTIFICATION FOR USE OF
TIME-AND-MATERIALS CONTRACTS

No. 91-030

January 8, 1991

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

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MEMORANDUM FOR UNDER SECRETARY OF THE DEFENSE FOR ACQUISITION
ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Final Report on the Audit of the Justification for Use of Time-and-Materials Contracts (Report No. 91-030)

This is our final report on the Audit of the Justification for the Use of Time-and-Materials Contracts for your information and use. Comments on a draft of this report were considered in preparing the final report. The Contract Management Directorate made the audit from March 1988 through January 1990 with the assistance of the U.S. Army Audit Agency and the Defense Contract Audit Agency. The initial objectives of the audit were to evaluate the use of time-and-materials contracts to determine if the use of other types of contracts would be more cost-effective, and to determine if contracting officers were properly justifying the use of time-and-materials contracts and establishing ceiling prices and systems to monitor contractor performance. We also evaluated the effectiveness of applicable internal controls. During the audit, we expanded our objectives to evaluate payments on time-and-materials contracts. The audit included multistage statistical tests from a universe of 1,234 time-and-materials contracts, with pricing actions valued at $1.4 billion. The DoD had about $7 billion of time-and-materials contracts for the period FY's 1986 through 1989.

Contracting officials inappropriately awarded 72 percent of the time-and-materials contracts used for support services when other contract types were more appropriate. Also, contracting officials did not perform effective surveillance over contractors' performance or costs and did not ensure that time-and-materials contracts were properly paid. Overuse of time-and-materials contracts increased the susceptibility of these procurements to abuse, mismanagement, and inadequate withholding of payments on the contracts, which increased interest cost. At the time of this report, the FY 1990 Defense Authorization Bill authorized the Secretary of Defense to develop a 3-year test program to use Master Agreements for Contracted Advisory and

Assistance Services. The implementation of this program should have a positive effect on limiting the use of time-and-materials contracts. The results of the audit are summarized in the following paragraphs, and the details, audit recommendations, and management comments are in Part II of this report.

DoD contracting officers routinely awarded time-and-materials contracts instead of fixed-price or cost-type contracts and failed to evaluate available historical cost and performance data in selecting the type of contract. As a result, about $1 billion in time-and-materials contracts were awarded in FY 1987 when more preferred contract types could have been awarded. We recommended that the Deputy Assistant Secretary of Defense (Procurement) issue a guidance memorandum to all DoD buying commands to use Master Agreements when obtaining technical or engineering support services, to review contract statements of work to assess the potential for awarding firm-fixed-price contracts, to highlight existing policy on the proper use of time-and-materials contracts, and to review the rationale for contract-type selection. We recommended that the respective Assistant Secretaries of the Military Departments require all buying commands to: establish training requirements for technical personnel, increase the level of training for contracting officers, and assess whether historical cost and performance data can be used to estimate the extent of work and cost of proposed acquisitions. We also recommended that the Assistant Secretary of the Navy (Research, Development and Acquisition) issue a policy memorandum to clarify the Navy's policy on the justification, selection, and use of time-and-materials contracts (page 7).

DoD contracting officials routinely did not withhold 5 percent of the invoiced direct labor charges on time-and-materials contracts. As a result, direct labor charges were prematurely paid at an estimated annual rate of $124 million. More stringent controls to enforce withholding provisions would avoid an estimated $12 million in annual interest costs or as much as $69.5 million over the next 6 years, if economic conditions remain the same. We recommended that the Deputy Assistant Secretary of Defense (Procurement) order revision of the Defense Federal Acquisition Regulation Supplement (DFARS) to clarify the $50,000 ceiling on withholdings being applied to Basic Ordering Agreements and indefinite delivery contracts, and to require contracting officers to prepare a written justification to waive or limit the percentage of withholding. We recommended that the Director of the Defense Contract Audit Agency issue a memorandum to all field offices reminding them to include an examination of the contract provisions pertaining to the 5-percent withholdings. Finally, we recommended that the Under Secretary of Defense (Acquisition) report the control over payments made on time-and-materials contracts as a material internal control weakness (page 21).

DoD contracting officials did not comply with Federal Acquisition Regulation (FAR) requirements to perform effective surveillance of time-and-materials contracts. In addition, the DFARS did not include policy and procedures regarding the appointment and authority of technical personnel assigned to contract surveillance functions. As a result, there was no assurance that the Government received the goods or services required under time-and-materials contracts. We recommended that the Deputy Assistant Secretary of Defense (Procurement) direct the Defense Acquisition Regulatory Council to make appropriate revisions to the DFARS. We recommended the respective Assistant Secretaries of the Military Departments require all buying activities to inform administrative contracting officers of technical personnel assigned to perform surveillance of time-and-materials contracts. We also recommended that the Director, Defense Logistics Agency, prevent payments of time-and-materials contract invoices unless the invoices are verified by an authorized Government representative, and ensure surveillance plans are used for all time-and-materials contracts assigned to a Defense Contract Administration Office. Finally, we recommended that the Under Secretary of Defense (Acquisition) report the inadequate surveillance of time-and-materials contracts as a material internal control weakness (page 31).

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. The review of internal controls is summarized in Part I of the report and weaknesses are detailed in Findings A. through C. We could not determine the monetary benefits to be realized by implementing recommendations in Findings A. and C. However, monetary benefits of an estimated $70 million could be realized by the U.S. Treasury over the next 6 years by implementing the recommendations in Finding B. if economic conditions remain the same. A copy of this report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense, the Military Departments, the Defense Contract Audit Agency, and the Defense Logistics Agency.

A draft of this report was provided on May 21, 1990, to the Under Secretary of Defense (Acquisition); the Assistant Secretary of Defense (Production and Logistics); the Comptroller of the Department of Defense; the Assistant Secretary of the Army (Financial Management); the Assistant Secretary of the Navy (Financial Management); the Assistant Secretary of the Air Force (Financial Management and Comptroller); the Director, Defense Contract Audit Agency; and the Director, Defense Logistics Agency. Comments were received from all addressees and are summarized in Part II of this report. The complete texts of the comments are in Appendixes Q through V.

The Assistant Secretary of Defense (Production and Logistics) generally concurred with the recommendations in Finding A. Based on the Assistant Secretary's comments, we revised Recommendations A.1.a. and A.1.c. We added Recommendation A.1.d. to the final report because the Navy contended that the Defense Procurement Management Review Manual should be revised to provide for a review of the rationale for contract-type selection. The Assistant Secretary generally nonconcurred with the recommendations in Finding B, contending that the recommended DFARS revisions to clarify the applicability of, and justification for, waiving FAR withholding provision 52.232-7 (a) were unnecessary. The Assistant Secretary stated that he would issue a policy memorandum that would clarify the issue and correct reported material internal control weaknesses. Nevertheless, we maintain that the recommended DFARS revisions are needed to correct widespread misconceptions concerning the application and waiver of the withholding provision. Based on the Assistant Secretary's comments and further discussions, we deleted draft report Recommendations B.1.a., B.3.a., and B.3.b. and revised draft report Recommendation B.1.b. We renumbered the recommendations for Finding B and request that the Assistant Secretary provide comments on Recommendations A.1.d., B.1.a., B.1.b., and B.3.

The Assistant Secretary partially concurred with Recommendation C.1.a. and satisfied the intent of the recommendation as worded; however, we reworded Recommendation C.1.a. to clarify our intent. Although the Assistant Secretary concurred with Recommendation C.1.b., his comments were not fully responsive for reasons stated in Part II of this report. Finally, the Assistant Secretary nonconcurred with Recommendation C.5., which addressed material internal control weaknesses. The basis for the Assistant Secretary's nonconcurrence was that the actions planned or taken will remedy the weaknesses cited in this report. We still consider Recommendation C.5. to be valid because the planned actions to resolve the material internal control weaknesses were not completely implemented. We ask that the Assistant Secretary respond to Recommendations C.1.a., and C.5. in this final report.

The Director of the Defense Contract Audit Agency responded for the Comptroller of the Department of Defense and nonconcurred with Recommendation B.2. The Director described an acceptable alternative action which we accepted, and we have revised our recommendation accordingly.

The Army neither concurred nor nonconcurred with Recommendations A.2.a., A.2.b., and A.2.c. The Army's comments indicated that our report did not provide specific documentation to substantiate the existence of systemic problems that these recommendations would reduce or eliminate. Nevertheless, the Army was taking action to determine if a systemic problem exists within the Army, and if so, will consider the merits of our recommendations. We believe our audit results showed convincing evidence that the

problems identified in our report were systemic within the Army as well as to DoD as a whole. Therefore, we request that the Army respond to Recommendations A.2.a., A.2.b., and A.2.c.

The Navy concurred with Recommendations A.2.a., A.2.c., and A.2.d. but did not state its planned actions. Although the Navy stated nonconcurrence with Recommendation A.3., we believe the planned action complies with the intent of the recommendation. The Navy nonconcurred with Recommendation A.2.b., stating that existing DoD procurement courses provide instruction on the proper selection of contract type. We consider Recommendation A.2.b. to be valid for reasons stated in Part II of the report. Also, the Navy nonconcurred with Recommendation C.2.b., stating that the Navy has already established procedures for reviewing contract officer representatives' administrative files. Based on Navy comments, we reworded Recommendation C.2.b. and added Recommendation C.4. to clarify our intent. Therefore, we ask the Navy to respond to this final report on Recommendations A.2.a., A.2.b., A.2.c., A.2.d., and C.4.

The Air Force concurred with Recommendations A.2.a., A.2.b., A.2.d., C.2.a., and C.2.b., and we consider its comments to be fully responsive.

The Defense Logistics Agency (DLA) nonconcurred with Recommendation C.3.a., stating that documentation of performance should be a requirement of the contract, not the surveillance plan. DLA also stated that it believed that no material internal control weakness existed on its part over the payments of time-and-materials vouchers. We revised Recommendation C.3.a. to clarify it and request that DLA reconsider its position in responding to the final report. DLA concurred with Recommendation C.3.b., and we consider its comments responsive.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Comments must be provided to us within 60 days of the date of this report. Recommendations A.1.d., B.4., and C.4. were added to the final report. These recommendations as well as the recommendations requiring additional comments and the recommendations that were revised for the final report are provided in Appendix W. The specific action needed to resolve each recommendation is in Part II of this report.

We determined that $69.5 million in monetary benefits would be realized by implementing Recommendations B.1.a., B.1.b., B.2., and B.3. This is an increase over the $56 million of monetary benefits cited in the draft report because we extended the estimated benefits over 6 years instead of 5 years. The Navy disagreed and DLA did not comment on the monetary benefits described in the draft report. The Air Force concurred with its portion of potential monetary benefits of about $5 million. A summary of potential benefits is shown in Appendix O. We request that the Navy and DLA review Finding B, reconsider their position

on the monetary benefits, and provide additional comments to the final report. The monetary benefits described in this report are subject to mediation in the event of nonconcurrence or failure to comment.

Please contact Mr. Salvatore D. Guli, Program Director, on (703) 614-6285 (AUTOVON 224-6285), or Mr. Ronald W. Hodges, Project Manager, on (703) 614-6264 (AUTOVON 224-6264), if you have any questions concerning this report. A list of the audit team members is in Appendix X. Appendix Y lists the distribution of this report. We appreciate the courtesies and cooperation extended to the team during this project.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Director, Defense Acquisition Regulatory Council

REPORT ON THE AUDIT OF THE JUSTIFICATION FOR USE OF TIME-AND-MATERIALS CONTRACTS

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Prepared by:
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REPORT ON THE AUDIT OF THE JUSTIFICATION FOR USE OF TIME-AND-MATERIALS CONTRACTS

PART I - INTRODUCTION

Background

The Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement (DFARS) provide for a variety of cost-reimbursement contract types whenever contracting officers cannot realistically predict the amount or duration of the contractual effort performed or the costs of that effort. The FAR also states that the least preferred type of cost-reimbursement contract is a time-and-materials contract. This contract provides for the acquisition of supplies and services based on reimbursing the contractor for labor hours at a specified fixed hourly rate and purchasing materials at cost. Fixed hourly rates include wages, overhead, general and administrative expenses, and profit. Time-and-materials contracts are not considered beneficial because they provide the contractor with no incentive to control material costs or manage the labor force efficiently.

FAR and DFARS guidance on the use of time-and-materials contracts is minimal; however, the FAR contains two requirements for the use of this type of contract. The contracting officer must determine that no other contract type is suitable, and the contract must contain a ceiling price. In addition, the FAR requires that the Government maintain appropriate surveillance of the contractor's performance and costs to ensure that efficient methods are used. Contracting officers are allowed to insert a payment clause for time-and-materials contracts which requires the withholding of 5 percent of the total labor amount claimed by the contractor, but not more than $50,000 on a contract or on an order issued under an indefinite delivery contract that requires a separate release by the contractor.

Time-and-materials contracts are high risk contracts because without extensive surveillance, they are susceptible to abuse. Thus, contracting officers should avoid the use of these contracts after experience provides a basis for firmer pricing. However, from FY's 1986 through 1989, the Individual Contracting Action Report (DD Form 350) on contracting actions valued at $25,000 or greater, showed a 40-percent increase in the number of time-and-materials contracts and a 62-percent increase in the dollar value of orders issued against those contracts. This trend toward greater reliance on time-and-materials contracts is evident in the following comparison of DoD's contract values.

Fiscal Year	Total DoD Contract Value (Billions)	Percent of Increase or (Decrease) Since FY 1986	Total DoD Time-and-Materials Contract Value (Billions)	Percent of Increase or (Decrease) Since FY 1986	Number of Time-and-Materials Contracts
1986	$145.7		$1.3		1,298
1987	142.5	(2.20)	1.7	30.77	1,453
1988	137	(5.97)	1.9	46.15	1,596
1989	129	(11.46)	2.1	61.54	1,812
Total	$554.2		$7.0		6,159

This frequent reliance on time-and-materials contracts is a result of the increased use of task order contracts by DoD buying activities. Criteria for the task order contract are not included in the FAR or DFARS. The task order contract is a form of time-and-materials contract that combines the terms of an indefinite delivery contract with the pricing arrangement of a time-and-materials contract. Generally, the contract is competitively awarded based on a technical proposal that addresses a hypothetical situation and to a great degree is based on the professional qualifications of personnel rather than on the offeror's response to a detailed specification. Task order contracts are increasingly used because contract statements of work are stated in very general terms. As specific requirements become known, task orders are issued to the contractor within the general statement of work. The principal rationale for using time-and-materials contracts is that administrative lead time is reduced because the basic contract is already in existence and all that is required is issuance of a task order, without soliciting and evaluating additional proposals. However, disadvantages to using time-and-materials contracts are that the Government assumes all the cost risks and the monitoring of contractor performance.

Objectives and Scope

Our objectives were to evaluate the use of time-and-materials contracts, to determine if the use of other types of contracts would be more cost-effective, to determine if contracting officers were properly justifying the use of time-and-materials contracts and establishing ceiling prices and systems to monitor contractor performance, and to evaluate the effectiveness of applicable internal controls. During the audit, we expanded our objectives to evaluate payments on time-and-materials contracts. To satisfy our objectives, we determined whether the award of time-and-materials contracts was fully justified and whether contract administration functions for time-and-materials contracts were adequately accomplished. Also, we determined whether 5 percent of the direct labor charges billed on time-and-materials contracts was withheld according to contract provisions, we computed the profit rate earned on selected time-

and-materials contracts, and we evaluated internal controls applicable to the use of time-and-materials contracts. The basic criteria used to perform the audit are contained in the FAR 16.601, "Time-and-Materials Contracts"; in the DFARS Part 216, "Types of Contracts"; and in local activity instructions. We reviewed contract files, payment records and related files, field pricing reports, contractor records, correspondence files, management review reports, and other documentation at procurement and administrative contract offices, the contractor's plant, and cognizant Defense Contract Audit Agency (DCAA) offices. We evaluated purchase requests, acquisition plans, justification and approval memorandums, determination and finding documents, technical and cost proposals, field pricing reports and preaward pricing, and DCAA audit reports.

During FY 1987, the Individual Contracting Action Report, DD Form 350 showed that DoD had a universe of 1,453 open time-and-materials contracts valued at $1.7 billion. We excluded 219 research and development time-and-materials contracts valued at $300 million from the universe. We statistically sampled 57 of the remaining 1,234 time-and-materials contracts valued at $1.4 billion to review the justification for use of time-and-materials contracts. A schedule of the 57 contracts is in Appendix A, and the sampling methodology is in Appendix B. Further, we judgmentally selected 10 contracts and performed a profit analysis with the assistance of the DCAA. A schedule of the 10 contracts is shown in Appendix D. Additionally, we statistically sampled and reviewed 433 payment records from a universe of 13,975 time-and-materials payment records at nine Defense Contract Administration Service Regions (now called Defense Contract Management Districts) and one major Air Force Payment Office to review the 5-percent withholding requirements (Appendix E). Appendix F shows the sample. Further, we judgmentally selected and reviewed 25 time-and-materials contract payment records at one major Navy payment office. Finally, we judgmentally selected 262 orders issued under the 57 sampled contracts to review the surveillance of time-and-materials contracts. A schedule of the 262 orders is in Appendix M. We visited or contacted activities listed in Appendix P and obtained the assistance of the DCAA and U.S. Army Audit Agency.

This performance audit was made from March 1988 through January 1990 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and accordingly, included such tests of internal controls as were considered necessary.

Internal Controls

A review of internal controls program documentation and its implementation showed that internal controls were inadequate to limit the use of time-and-materials contracts as required by the FAR. Further, internal controls were not adequate to enforce the 5-percent withholding provisions and to ensure the reasonableness of costs incurred on time-and-materials contracts.

Recommendations 2.a., 2.b., 2.c., 2.d., and 3. in Finding A; Recommendations 1.a., 1.b., 2., and 3. in Finding B; and Recommendations 1.a., 1.b., 3.a., and 5. in Finding C; if implemented, will correct these weaknesses.

Prior Audit Coverage

Air Force Audit Agency Report No. 7076413, "Use of Time-and-Materials Contracts within Air Force Logistics Command," August 18, 1988, stated that procedures and internal controls were not effective to limit time-and-materials contract use to only those cases where no other contract type was suitable, that Air Force contracting officials did not send time-and-materials contracts to DCAA for surveillance, and that contract price negotiations included overstated profit objectives. The report recommended that Air Force Logistics Command (AFLC) personnel discontinue the use of time-and-materials contracts when data are available to negotiate fixed-price contracts, distribute time-and-materials contracts to DCAA, and document justification for profit calculations. Headquarters, AFLC, concurred with the recommendations, and the Air Force Audit Agency determined that the actions taken were responsive to the issues and recommendations discussed.

Office of the Assistant Inspector General for Audit Policy and Oversight, Department of Defense, Report No. APO 87-009, "Report on Oversight Review of Time-and-Materials Contracts by the Defense Contract Audit Agency," May 29, 1987, stated that the DCAA needed to clarify audit policy guidance to improve audit coverage of time-and-materials contracts. This report also cited deficiencies in floor checks on time-and-materials contracts, inadequate testing on personnel qualifications, and insufficient evaluations of incurred labor costs/hours. The report recommended clarification of requirements for floor checks for all auditable time-and-materials contracts and reemphasized the need for adequate coverage on time-and-material/labor hour contracts. Revisions were recommended for the Contract Audit Manual and recommendations were made for DCAA to clarify the auditor's role in surveillance over time-and-materials contracts. A recommendation was made to the Deputy Assistant Secretary of Defense (Procurement) to reemphasize the requirement to provide copies of all auditable contracts (including time-and-materials) to DCAA.

DCAA concurred with three of four recommendations and concurred, in principle, with the recommendation clarifying requirements for floor checks. Contract Audit Manual revisions were prepared for comparison of costs incurred and funding amounts and for the comparison of the qualifications of employees to the requirements of the contract. Also, the Contract Audit Manual was revised to address the need for the DCAA auditor to coordinate with the Contracting Officers' Technical Representative (COTR). Finally, the Deputy Assistant Secretary of Defense for Procurement's memorandum of January 7, 1987, reemphasized the requirement to provide copies of all auditable contracts to the DCAA.

PART II - FINDINGS AND RECOMMENDATIONS

A. Use of Time-and-Materials Contracts

FINDING

For about 72 percent of the time-and-materials contracts awarded during the period audited, DoD contracting officers should have used a fixed-price or a more preferred cost-type contract when obtaining support services. This occurred because contracting officers did not use historical cost and performance data to estimate contract cost, and they often lacked experience in using fixed-price and other cost-type contracts. Also, contracting officers considered time-and-materials contracts easy to use, requiring less administrative lead time than fixed-price or cost-type contracts. Further, technical personnel lacked sufficient training to prepare statements of work based on information from previous contracts. In some instances, Navy contracting officers thought that Navy officials preferred using time-and-materials contracts. This resulted in justifications for use of time-and-materials contracts that were not prepared in sufficient detail to support the decision that no other contract type was appropriate. As a result, about $1 billion in time-and-materials contracts were awarded in FY 1987 when more preferred contract types could have been awarded.

DISCUSSION OF DETAILS

Background. Selection of an appropriate contract type depends on numerous factors including how well the Government can define the work to be performed when it solicits bids or proposals. The FAR states that the objective, when selecting the contract type, is to provide for reasonable contractor risk and maximum contractor incentive to efficiently and economically perform. When cost uncertainties are too great, the FAR provides for a variety of cost-reimbursement-type contracts, such as cost-plus-fixed-fee and cost-plus-award-fee contracts. However, the least preferred type of cost-reimbursement contract is a time-and-materials contract.

Time-and-materials contracts are used to acquire supplies and services at a specified fixed hourly rate that includes direct labor, indirect cost, and profit. Materials are provided at cost. This type of contract is designed for first time efforts or to perform emergency repair work where the amount or duration of work cannot be predicted and where costs cannot be realistically estimated. According to the FAR, time-and-materials contracts should be used only when no other contract type is suitable. The use of this contract is not desirable in most situations because the method of charging expenses does not provide the contractor with an incentive to control costs or manage the labor force.

Because the Government assumes added cost risk in awarding time-and-materials contracts, the FAR provides that the contracting officer must prepare a written determination and finding that no other contract type is suitable. A determination and finding document is the contracting officer's rationale for awarding a time-and-materials contract. The Defense Federal Acquisition Regulation Supplement (DFARS) provides that reviews be made of contract statements of work and cost and performance data from prior contracts, when considering contract type. The results of these reviews must be documented in the contract files.

Other Contracts with Time-and-Materials Pricing Arrangements. The FAR discusses two other commonly used methods for procuring supplies and services, indefinite delivery contracts and Basic Ordering Agreements (BOA's). FAR, Subpart 16.5, "Indefinite Delivery Contracts," states that indefinite delivery contracts may be used when the Government anticipates recurring requirements, but cannot determine the precise amount of supplies or services. FAR 16.703, "Basic Ordering Agreement," provides that a BOA is a written understanding that contains terms and clauses applicable to future contracts or orders. A description of supplies and services to be provided and methods for pricing, issuing, and delivering future orders are normally included in these agreements. Orders issued under a BOA are contracts because each order is subject to FAR competition and synopsis requirements. By comparison, the orders under indefinite delivery contracts are not synopsized or competed.

Another type of acquisition arrangement, the task order contract, is used for procuring services when procurement lead time is short. Criteria for use of task order contracts as a procurement vehicle are not included in the FAR or the DFARS. However, task order contracts are commonly used by DoD buying commands. The task order contract is a combination of an indefinite delivery contract and a time-and-materials pricing arrangement. The contract is awarded based on a very broad and general statement of work for a specific period. As specific requirements become known, task orders are issued to the contractor. Before each task order is issued, the Government prepares a detailed statement of work, explaining the specific tasks to be accomplished by the contractor and an estimate of the number and type of labor hours required to perform the task. For purposes of this report, the term "time-and-materials contract" will be used to cover time-and-materials contracts, indefinite delivery contracts, task order contracts, and BOA's using time and materials pricing arrangements.

Results of Audit. Our universe consisted of 1,234 open time-and-materials contracts for FY 1987 valued at $1.4 billion. We statistically sampled and reviewed 57 of these contracts valued at $214 million to assess whether the use of time-and-materials contracts was justified. We found that

41 (72 percent) of the time-and-materials contracts were awarded even though historical cost and performance data were available to estimate costs and the extent of work required at the time the contract was awarded or at the time the specific work materialized (results of contracts reviewed are shown in Appendix A).

Use of Historical Costs and Performance Data. In 41 instances, procurement officials did not use available historical cost and performance data from previous contracts to determine and select the most appropriate contract type to be awarded. Available information from previous contracts was not reviewed when evaluating whether to use a contract type other than a time-and-materials contract. Instead, contracting officers conveniently used a task order contract even though previous contracts were awarded for the same or similar requirements. Of the 41 time-and-materials contracts, 30 were task order contracts. Of these 30 contracts valued at $91.1 million, 8 contracts, valued at $19.1 million, were awarded for repair and maintenance support efforts. The remaining 22 contracts, valued at $72 million, were used to obtain technical and engineering support services. Procurement officials stated that the task order contract was the only logical contract type because it provided more convenience to the command by:

- allowing the command to satisfy an indefinite number of requirements during the contract period,

- reducing the administrative costs, and time and energy requirements associated with individual contracts, and

- improving controls over specific funds associated with a specific task that had been difficult to accomplish in a normal cost-type contract.

We found several deficiencies associated with the use of task order contracts when historical cost and performance data were available. Details follow.

Repair and Maintenance Support Services. For the eight repair and maintenance contracts, our review showed that sufficient information was available from previous contracts to predict the repair costs of individual items, although the specific quantity of repair items was unknown at the time the basic contract was awarded. For example, contract F40606-86-0056, valued at $2.2 million, was a time-and-materials contract awarded to obtain repair and maintenance support for an F-111 aircraft adapter. The contractor had extensive experience under previous contracts awarded from FY 1981 to FY 1986. Since the contractor had sufficient cost data, a Defense Contract Administration Services cost analyst suggested that the contracting officer use historical costs to price the repairs.

Additionally, we found that the Air Force had issued its own maintenance report (A-G072D-L50-MO-8IT) that contained the average hours needed for various repairs for the same adapter. Accordingly, there were sufficient historical cost and performance data relative to the work to be performed to establish a prearranged fixed-price type contract on a per item basis. This would have allowed the command to order an indefinite quantity of repairs at a fixed unit price after the requirements materialized.

Fixed-price contracts were not used primarily because technical personnel assigned to prepare the statements of work were not always provided training in developing comprehensive work statements based on historical cost and performance data. We believe there is a need for the Services to increase the level of training for those untrained technical personnel tasked to prepare statements of work. For example, we asked 46 of these individuals whether they received any formal training on preparing statements of work. Only 10 of the 46 personnel had received formal training. Consequently, the untrained personnel did not prepare comprehensive statements of work that could be used to award cost or fixed-price contracts. This indicates that inadequate training was a contributing factor to the overuse of time-and-materials contracts.

Technical/Engineering Support. Contracting officers awarded 22 (task order) contracts valued at $72 million for technical/engineering support services. These task order time-and-materials contracts were used even though 80 percent of the individual tasks were the same or similar to tasks that had previously been contracted. This occurred because technical/engineering requirements were not always known at the time of contract award. Also, technical personnel did not review information from prior contracts to develop detailed statements of work needed for fixed-priced solicitations. For example, we asked 46 technical personnel if historical cost and performance data were accumulated and analyzed to develop fixed-priced solicitations and contracts. Appendix A shows that only five personnel (11 percent) acknowledged using historical cost and performance data to solicit fixed-price contracts. However, when these same individuals were asked how they prepared detailed statements of work and cost estimates for individual orders, they all stated that the statements of work and cost estimates were prepared based on previous task orders.

Based on these interviews and review of applicable records, we concluded that at least 90 percent of the individual orders could have been awarded as normal cost-type or fixed-price orders under a BOA. However, procurement officials at one major Navy buying command stated that a BOA was cumbersome and required too much administrative lead time to award individual orders. BOA's were cited as cumbersome because of the requirement that each order issued against a BOA ($25,000 or greater) must be

competed. These officials informed us that they also had problems associated with the task order contract when obtaining technical/engineering support efforts. Their major problem was the reliance on competition in awarding the basic contract. They stated that competition would be more meaningful if they could predict enough about the actual work to be performed at the time the basic contract was awarded. Procurement officials suggested another alternative would be to award contracts to a number of contractors for the same general services. When the individual requirement was fully defined, it would be competed among the contract holders and awarded to the contractor that offered the best value for the specific requirement.

The alternative described above was basically the same as the master agreement that was approved for limited use in the FY 1990 Defense Authorization Act. This provision was codified in United States Code, title 10, section 2304, paragraph J. It authorized the Secretary of Defense to develop a 3-year test program to use Master Agreements for Contracted Advisory and Assistance Services. Services procured with the Agreement must be consistent with DoD Directive 4205.2, "DoD Contracted Advisory and Assistance Services" and Office of Management and Budget (OMB) Circular A-120, "Guidance for the Use of Consultants Services." During FY 1987, 57 percent of the time-and-materials contracts were awarded for technical/engineering support services. Technical/engineering support services were mostly advisory and assistance services as defined by DoD Directive 4205.2 and OMB Circular A-120. Therefore, we believe that DoD could significantly reduce the number and value of time-and-materials contracts by using a BOA or Master Agreement when obtaining technical/engineering support services. BOA's and Master Agreements would provide the contracting officer the flexibility needed to choose the most appropriate pricing arrangement once the specific requirement was defined and would enhance competition by basing the award on a thorough comparison of detailed technical approaches and costs between competing vendors.

Contracting Officers' Experience. Contracting officers used BOA's to obtain technical/engineering and repair and maintenance support services for 10 time-and-materials contracts valued at $60 million. However, 9 of the 10 BOA's were structured to provide that only time-and-materials contracts could be awarded. Thus, even when the specific requirement was defined in sufficient detail to award a more preferable contract type, these contracting officers consistently awarded time-and-materials contracts. This occurred primarily because contracting officers lacked adequate training or experience in obtaining support services when using BOA's. For example, we asked the 10 contracting officers associated with these BOA's whether they had experience in awarding other types of contracts for support service. Only 3 of the 10 had any such experience. We believe

that contracting officers lacking experience in awarding various types of contracts for support efforts should be provided additional training in this area.

Navy Policy on Time-and-Materials Contracts. Procurement officials who were responsible for the award of over half of the Navy's time-and-materials contracts indicated that the implied preference of time-and-materials contracts by senior Navy procurement officials influenced their decision to award this contract type. Appendix C shows that procurement officials perceived that the Assistant Secretary of the Navy (Research, Development and Acquisition) preferred time-and-materials contracts. However, responsible personnel at the Assistant Secretary's office stated that they had not expressed any preference for the use of such contracts. Nevertheless, the Navy contracting officers' perceptions that time-and-materials contracts were preferred was a major factor in their use by these officials. Therefore, we believe that the Assistant Secretary should clarify his position regarding the use of time-and-materials contracts.

Use of Determinations and Findings. Determinations and findings used to support the selection of contract type did not adequately justify the use of time-and-materials contracts. To permit the use of a time-and-materials contract, both the FAR and DFARS require a determination and finding. The determination and finding concludes that the proposed contract is likely to be "less costly" or that "it is impracticable to obtain the services of the kind or quantity required without using such a contract." FAR 1.704 indicated that determinations and findings should clearly and convincingly justify the specific determination made to award a time-and-materials contract.

We examined the determinations and findings for all 57 time-and-materials contracts. The most frequently used reasons for selecting the time-and-materials contract was that it was "less costly." However, we could not find any analysis or other documentation supporting the conclusion that time-and-materials contracts were less costly. In fact, we determined that actual profit earned on time-and-materials contracts was about twice as much as the profit earned on normal cost-type contracts, when obtaining support services. Our determination was based on a comparison of the average profit of 19.1 percent profit on 10 time-and-materials contracts, and the not to exceed 10-percent fee or profit for cost-type contracts as required by FAR Subpart 15.9, "Profit" (Appendix D).

We realize that the inadequacy of the documentation supporting the use of the time-and-materials contract does not necessarily indicate that the contract was inappropriate. However, we believe that by assessing whether information from previous contracts could be used to award a more preferred contract type,

contracting officers will be able to better justify contract type selection and prepare determinations and findings that support their decisions.

Conclusion. Additional measures are needed within DoD to limit the use of time-and-materials contracts in accordance with policies cited by the Office of Federal Procurement Policy (OFPP) in the Office of Management and Budget memorandum, No. M-89-21, dated July 17, 1989. In this memorandum, DoD was requested to identify and correct deficiencies that contributed to poor or improper procurement practices. In the memorandum, OFPP stated that particular attention should be given to the "use of inappropriate contract types." Our audit results showed that an estimated $1 billion (± 32 percent sampling error) of time-and-materials contracts were awarded without adequate analysis or justification (Appendix B). Thus, DoD was exposed to a higher level of cost risk than would have resulted with the use of a more preferred contract type.

RECOMMENDATIONS, MANAGEMENT COMMENTS AND AUDIT RESPONSE

The Assistant Secretary of Defense (Production and Logistics), Assistant Secretary of the Army (Research, Development and Acquisition), Assistant Secretary of the Navy (Research, Development and Acquisition), and Assistant Secretary of Air Force (Acquisition) provided comments on the findings and recommendations. The complete texts of the comments are in Appendixes Q, S, T, and U. Draft Report recommendations A.1.a., A.1.c., and A.3. were revised in this final report. Recommendation A.1.d. was added to this final report.

Recommendations to the Deputy Assistant Secretary of Defense (Procurement)

Recommendation A.1.a. We recommend that the Deputy Assistant Secretary of Defense (Procurement) issue a guidance memorandum to all DoD buying commands limiting their use of time-and-materials contracts by highlighting the existing policy on the proper use of time-and-materials contracts.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) partially concurred with the recommendation as stated in the draft report. The Assistant Secretary stated that regulations already provide that the contracting officer execute a determination and finding that no other contract type is suitable before awarding a time-and-materials contract. Nevertheless, DASD(P) will issue a guidance memorandum highlighting the existing policy on the proper use and administration of time-and-materials contracts.

Audit Response. We accept the Assistant Secretary's alternative. Therefore, we have reworded our recommendation and comments are considered responsive.

Recommendation A.1.b. We recommend that the Deputy Assistant Secretary of Defense (Procurement) issue a guidance memorandum to all DoD buying commands limiting their use of time-and-materials contracts by using Master Agreements for procuring future technical/engineering services currently procured under time-and-materials contracts. Technical/engineering services are defined as contracted advisory and assistance services by DoD Directive 4205.2 and such services can be procured through Master Agreements under U.S.C., title 10, section 2304, paragraph J.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) (ASD[P&L]) concurred with Recommendation A.1.b., stating that DoD requested and was granted authority to use Master Agreements to facilitate the acquisition of needed study, advisory, and assistance services on a timely basis. Policy on the use of Master Agreements will be issued to all DoD Components through DFARS and will be effective with the issuance of the next quarterly Defense Acquisition Circular in October 1990.

Audit Response. The comments from the Assistant Secretary on Recommendations A.1.b. are fully responsive.

Recommendation A.1.c. We recommend that the Deputy Assistant Secretary of Defense (Procurement) issue a guidance memorandum to all DoD buying commands limiting their use of time-and-materials contracts by reviewing contract statements of work to assess the potential for awarding firm-fixed-price contracts before obtaining support efforts on follow-on contracts.

Management Comments. ASD (P&L) concurred with Recommendation A.1.c., stating that DASD (P) has issued a memorandum reminding contracting officers of their responsibilities to review statements of work to assess the potential for awarding firm-fixed-price contracts, especially for follow-on efforts.

Audit Response. The Assistant Secretary's comments are considered fully responsive.

Recommendation A.1.d. We recommend that the Deputy Assistant Secretary of Defense (Procurement) revise the Defense Procurement Management Review Program Manual by issuing a policy memorandum that provides for a review by all DoD buying commands of the rationale for contract type selection.

We added Recommendation A.1.d. to the final report because we agreed with the Navy's comment that the Defense Procurement Management Review Manual did not require a review of the rationale justifying contract type selection. We also agreed with the Navy's contention that such a review is a proper Procurement Management Review function. Therefore, we request

that the Assistant Secretary respond to the final report indicating concurrence or nonconcurrence with the added recommendation.

Recommendations to the Assistant Secretary of the Army (Research, Development and Acquisition), Assistant Secretary of the Navy (Research, Development and Acquisition), and Assistant Secretary of the Air Force (Acquisition)

Recommendation A.2.a. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying commands to establish minimum training requirements for technical personnel responsible for preparing statements of work and assessing historical cost and performance data for support service contracts.

Army Comments. The Army neither concurred nor nonconcurred with Recommendation A.2.a., stating that our report did not provide specific documentation to substantiate the existence of systemic problems that this recommendation would reduce or eliminate. However, the Army was taking action to determine if a systemic problem exists within major buying commands. Based on the results of this action, the Army will consider the merits of our recommendation.

Audit Response. We disagree with the Army's comments and consider them nonresponsive to Recommendation A.2.a. It should be noted that most of the Army's technical personnel reviewed were not adequately trained before writing statements of work for support contracts. Therefore, the intent of our recommendations was to increase the level of training for those technical personnel tasked to prepare statements of work but who lacked the necessary experience or training. We request that the Army provide additional comments to the final report.

Navy Comments. The Navy concurred with Recommendation A.2.a. and stated that selection of contract type is a responsibility of the contracting officer, not the technical personnel who are responsible for preparing the statement of work.

Audit Response. Although the Navy concurred with Recommendation A.2.a., the comments did not state what planned action is to be accomplished and when it will be completed. Therefore, we request that the Navy provide this information in response to this final report.

Air Force Comments. The Air Force concurred with Recommendation A.2.a., stating that its technical people prepare statements of work from time-to-time, rather than on a day-to-day basis and, therefore, establishing minimum training requirements

may not cure the problem. Therefore, a letter will be issued to buying commands emphasizing the need to carefully train technical personnel before they are tasked to write statements of work or to assess historical cost and performance data. The letter will also direct buying commands to provide this training. Planned actions were to be completed by October 1990.

Audit Response. The Air Force comments are considered fully responsive.

Recommendation A.2.b. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying commands to increase the level of training for contracting officers lacking experience in awarding various contract types for support services contracts.

Army Comments. The Army neither concurred nor nonconcurred at this time with Recommendation A.2.b. for reasons discussed in Recommendation A.2.a.

Audit Response. The Army's comments were nonresponsive to Recommendation A.2.b. It should be noted that 19 of the 27 contracting officers reviewed did not have the necessary hands-on experience that could be gained by in-house training. Therefore, the intent of our recommendation was to increase the in-house training and experience for those contracting officers who lacked the necessary experience in awarding various types of contracts for support services. We ask the Army to reconsider its position in reply to the final report.

Navy Comments. The Navy nonconcurred with Recommendation A.2.b., stating that existing DoD procurement courses provide instruction on the proper selection of contract type.

Audit Response. Our recommendation was intended to increase the in-house training and experience for those contracting officers who lacked the necessary experience in awarding various contract types for support services. As discussed in the finding, 19 of the 27 contracting officers reviewed did not have the necessary hands-on experience that could be gained by in-house training to implement FAR Part 16 requirements. We also believe that without the hands-on experience in awarding various types of contracts or continuous in-house training on selection and use of the most appropriate contract type for each acquisition, contracting officers will not be able to fully comply with FAR and DFARS requirements concerning contract selections. Therefore, we request the Navy to reevaluate its position in its reply to the final report.

Air Force Comments. The Air Force concurred with Recommendation A.2.b., stating it will issue a letter to buying commands emphasizing the need to adequately train contracting officers on various types of contracts suitable for support services. The letter also will direct buying commands to review training plans and individual contracting officer's training folders to ensure that this training is being performed. This action was to be completed in October 1990.

Audit Response. The comments from the Air Force were fully responsive.

Recommendation A.2.c. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying commands to assess whether historical cost and performance data from previous contracts can be used to estimate the extent of work and cost of proposed acquisitions.

Army Comments. The Army neither concurred nor nonconcurred at this time with Recommendation A.2.c. for reasons discussed in Recommendation A.2.a.

Audit Response. The Army's comments were nonresponsive to Recommendation A.2.c. It should be noted that 9 of the 16 statistically sampled time-and-materials contracts for the Army were awarded even though historical cost and performance data were available to estimate costs and the extent of work. Therefore, the intent of our recommendation was to establish a means of ensuring that historical cost and performance data were used when determining the contract type. We request that the Army provide additional comments to the final report.

Navy Comments. The Navy concurred with Recommendation A.2.c. and stated that the review should be the responsibility of the requiring activity or the contracting officer's representative.

Audit Response. Although the Navy concurred, its comments were not responsive to the recommendation. The audit showed that procurement officials did not assess whether historical cost and performance data from previous contracts could be used to estimate the extent of work and cost of proposed acquisitions on 15 of the 19 contracts reviewed. The Navy did not specifically address the issues in the recommendation. The comments do not state how the action is to be accomplished and when it will be completed. Therefore, we request that the Navy reconsider its position and provide additional comments to the final report.

Air Force Comments. The Air Force concurred with Recommendation A.2.c. and stated that a letter will be issued to the field stressing the importance of assessing historical cost and performance data in defining the follow-on contractual efforts and determining the type of contract best suited for the specific effort. This action was to be completed by October 1990.

Audit Response. The Air Force comments were fully responsive.

Recommendation A.2.d. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying commands to include reviews of determination and findings documents and justifications for use of time-and-materials contracts in command inspections to ensure that analyses and supporting documentation clearly justify the selection of a time-and-materials contract.

Army Comments. The Army concurred in principle with Recommendation A.2.d., stating that the chief of the contracting office is required to review and approve determinations and findings documents for use of time-and-materials contracts. However, the Army will include reviews of determinations and findings documents for contract type in its Procurement Management Review Program. In addition, it will request that the Inspector General for the Department of the Army include reviews of determinations and findings documents during command procurement inspections. The estimated completion date for this action is September 30, 1990.

Audit Response. The comments from the Army were considered fully responsive.

Navy Comments. The Navy concurred with Recommendation A.2.d. and acknowledged that the Defense Procurement Management Review Manual does not explicitly provide for a review of the rationale for contract type selection. They also agreed that such a review is a proper Procurement Management Review (PMR) function.

Audit Response. We agree that the Defense Procurement Management Review Manual does not explicitly require a review of the rationale justifying contract type selection, and we have added Recommendation A.1.d. accordingly. Nevertheless, we believe the Navy should include a review of determinations and findings documents in its PMR's, since the Navy agrees that a review of the rationale justifying the use for time-and-materials contracts is a proper PMR function. Therefore, we request that the Navy state how the action is to be accomplished and when it will be completed, in response to this final report.

Air Force Comments. The Air Force concurred with Recommendation A.2.d., stating that the use and proper documentation of time-and-materials contracts is one of its priority topics. Presently, the Air Force Logistics Command Inspector General is conducting a thorough inspection throughout all buying commands in this area. Furthermore, a letter will be issued to the field directing all buying activities to include reviews of determinations and findings documents justifying the use of time-and-materials contracts in command inspections. This action was to be completed by October 1990.

Audit Response. The Air Force comments are considered fully responsive.

Recommendation A.3. We recommend that the Assistant Secretary of the Navy (Research, Development and Acquisition) issue clear guidance to Navy buying commands correcting the apparent misconception that senior Navy procurement officials preferred time-and-materials contracts.

Management Comments. The Navy nonconcurred, stating that buying commands already know that the Navy's policy on contract types is contained in the FAR and DFARS, with time-and-materials contracts being one of the least preferred.

Audit Response. Although the Navy nonconcurred with Recommendation A.3., we were provided a memorandum, dated October 3, 1990, issued to all Navy buying commands clarifying the Navy's position regarding use of time-and-materials contracts (Appendix T, page 8 of 8). Therefore, the Navy's action satisfies the intent of the recommendation.

Finding A

Management Comments. The Navy stated that the objectives of the audit were not met. It also stated that the discussion in Finding "A" confuses time-and-materials and task order contracting and focused on downplaying some important benefits of the latter. The Navy alleged that the report also failed to distinguish between task order contracts using time-and-materials pricing arrangements and cost-reimbursable pricing arrangements. There are advantages and disadvantages to both forms, and occasions where the use of one would be preferable to the other.

Furthermore, the Navy stated that the proposed recommendations do not adequately address the problem discussed in the report. In many cases, the recommended policies already exist, and the recommended training is already being provided.

Audit Response. The Navy's assertion that the objectives of the audit were not met is not accurate. It should be noted that the objective of the audit was not to look at all types of task

order contracts, but only those that feature the least preferred (time-and-materials) pricing arrangement. Therefore, the functional focus of the audit was the review of time-and-materials contracts. We also discussed both the advantages and disadvantages of task order contracts in the context of the audit objective as shown on pages 7 through 9 of this report.

Many problems identified in our report are the results of noncompliance with existing FAR and DFARS policies. Therefore, the intent of our recommendations was to reemphasize existing policies, to establish an oversight process as a means of ensuring compliance with existing policies and to increase the in-house training and experience for those contracting officers and other personnel who lacked the necessary experience in awarding various types of contracts for support services.

B. Payments on Time-and-Materials Contracts

FINDING

DoD contracting officials did not fully enforce the contractual payment clause which required the withholding of 5 percent of the invoiced direct labor charges on time-and-materials contracts. This occurred because the various officials did not properly understand and carry out their responsibilities. Additionally, the FAR was not specific enough to preclude widespread misinterpretations of the withholding provision. There was a lack of specific guidance that defined the Defense Contract Audit Agency (DCAA) role in enforcing the withholding provision during public voucher examination and approval. In many instances, contracting officials were unaware of the required withholding provisions. Further, some contracting officers questionably waived withholding provisions. As a result, DoD officials prematurely paid direct labor charges to contractors at an estimated annual rate of $124 million. Enforcement of the 5-percent withholding provisions would have saved the U.S. Treasury at least $12 million in annual interest costs and as much as $70 million over the next 6 years, at the current level of time-and-materials procurements. Failure to enforce the 5-percent withholding provision constituted a material internal control weakness reportable to the Secretary of Defense.

DISCUSSION OF DETAILS

Background. Time-and-materials contracts are high risk contracts because they provide no incentive for the contractor to control cost. These contracts require extra measures to protect the interests of the Government. FAR contract clause 52.232-7(a), "Payments Under Time-and-Materials and Labor Hour Contracts," provides for this protection by requiring that 5 percent of invoiced direct labor charges (up to a maximum $50,000 per contract) be withheld until the contractor executes and delivers a release and the Government performs a final audit of the contract costs.

DoD Directive 5105.36, change 1, "Defense Contract Audit Agency," March 17, 1983, assigns DCAA responsibility for examining and approving time-and-materials vouchers. Paragraph (D)(4) of the Directive states that the DCAA shall examine reimbursable vouchers received directly from contractors under cost-type contracts and transmit approved vouchers for payment to the cognizant disbursing officer. For vouchers that are disapproved, a DCAA Form 1 (Notice of Contract Costs Suspended and/or Disapproved), which identifies the unallowable costs, will be submitted to the cognizant contracting officer. Furthermore, the FAR assigns contract administration functions to Administrative Contracting Officers (ACO's). Defense Logistics Agency Manual (DLAM) 8105.1, "Contract Administration Services," change 6, September 22, 1988, section 16. 601-3(D), requires the ACO to

ensure that 5 percent of the direct labor charges is withheld from the contractor's vouchers, unless the requirement was altered or waived. Because of concerns pertaining to the $50,000 maximum withholding limitation, Defense Logistics Agency (DLA) issued a policy letter dated March 4, 1988, (Appendix H) to all Defense Contract Administration Services Regions. The policy letter stated that the FAR's $50,000 maximum withholding limitation should be applied to each order issued under a Basic Ordering Agreement (BOA) or an indefinite delivery contract that contains time-and-materials pricing arrangements. DLA's rationale was based on the past practice of both private industry and the Government. However, the Navy's interpretation of the FAR, regarding the application of the withholding provision, was different from DLA's. The Navy's policy, contained in a January 13, 1989 letter, stated in part that the $50,000 withholding limitation is the cumulative amount that can be withheld for the "entire contract." Appendix I shows the full text of the Navy's policy letter. The Army and Air Force did not issue policy letters interpreting the FAR's $50,000 maximum withholding limitation on time-and-materials contracts.

Details of the Audit. We statistically selected and reviewed time-and-materials payment vouchers, active as of July 1989, for 343 orders from a universe of 10,528 orders valued at $4.5 billion at the Philadelphia, Boston, New York, and Los Angeles DCASR's; and 90 orders from a universe of 1,677 orders valued at $1.3 billion at the Air Force Contract Management Division, Kirtland Air Force Base (AFB) (Appendix F). We judgmentally selected and evaluated payment vouchers for 25 of 52 contracts at the Naval Supply Center, Charleston, South Carolina. We also obtained and reviewed applicable payment policies and, with the assistance of the U.S. Army Audit Agency (USAAA), interviewed contracting officials at procurement offices, DCASR's, and the Defense Contract Audit Agency. We estimated that DoD did not withhold 5 percent of the labor charges on about 60 percent of the DCASR's vouchers, on 94 percent of the Navy's vouchers, and on 52 percent of the Air Force's vouchers processed for time-and-materials contracts. This under withholding was at an estimated annual rate of $124 million. Details are discussed in the following paragraphs.

Defense Contract Administration Services Regions. We reviewed payments of direct labor charges, valued at $96 million, for 343 time-and-materials delivery orders valued at $195 million. About $2.2 million (see Appendix G) of the direct labor charges was not withheld based on the contracts' withholding provisions and a $50,000 ceiling per order. This occurred because the procedures to review and approve vouchers for payment did not provide the necessary controls to ensure that a portion of the direct labor charges would be withheld as required by the contract clause.

There was a breakdown of controls in the system for ensuring that direct labor payments would be limited. Although ACO's or Contracting Officer Representatives (COR's) were responsible for certifying direct labor hours charged by contractors, they did not review invoices or vouchers to see if contractors conformed with the withholding provisions of time-and-materials contracts. Instead, contractors issued certificates of performance, which attested to the hours worked for each billing period. ACO's or COR's certified that the work was accomplished and hours charged were reasonable by approving the certificates of performance. Contractors were instructed, by contract invoicing procedures, to forward vouchers to specific DCAA offices for review and approval. The Defense Contract Audit Manual states that the auditor should determine that payments of items listed on public vouchers are not precluded by any contractual provisions. However, DCAA did not review public vouchers to ensure that 5 percent of the labor charges had been withheld. Instead, DCAA approved public vouchers for payment based on a review of labor and overhead rates before the vouchers were submitted to designated payment offices. These approved public vouchers provided the basis for payment. Thus, enforcement of the 5-percent withholding provision was left to paying offices.

Personnel responsible for examining vouchers at the payment office did not deduct 5 percent of the labor charges, even though most contracts contained the 5-percent withholding clause. This occurred because many contractors' vouchers were paid through the DCASR automatic pay system. Under this system, information from contractors' invoices is entered into the automated pay system, which generates a check for the invoiced amount. Voucher examiners do not review vouchers paid under the automatic pay system. Personnel at one payment office stated that since vouchers were reviewed and approved for provisional payment by DCAA, it was not necessary for examiners to check for the withholding deduction. They suggested that the contractor should be required to deduct the required withholdings similar to other cost-type contract payments. We noted that in instances where the contractor voluntarily deducted the required withholdings, the proper deduction was consistently withheld.

We projected our results to the total direct labor charges of $4.4 billion on 12,298 orders at 9 DCASR's, and estimated that $109 million should have been withheld, but was prematurely paid to contractors (Appendix J).

Naval Supply Center-Charleston, South Carolina. The payment office at the Naval Supply Center (NSC) Charleston, South Carolina, was responsible for payments on 8,980 delivery orders issued under 52 time-and-materials basic contracts valued at over $363 million. We reviewed payments of $145 million in direct labor charges for 25 selected contracts. We found that $5.9 million (94 percent) of $6.3 million of direct labor charges

was not withheld as required by contract withholding provisions (see Appendix G). Withholdings were not made because Navy Contracting Officer Technical Representatives (COTR's), assigned to certify and approve invoices, were unaware of the requirement to, or were not instructed to, ensure that the 5 percent was withheld. The Navy's policy of limiting withholdings to $50,000 for the entire contract instead of each delivery order also contributed to the underwithholding of direct labor charges (see Appendix I).

DCAA approved the vouchers for payment when COTR's were not assigned approval responsibility. DCAA reviews did not include an analysis of withholding provisions because the review of time-and-materials vouchers was limited to an examination of labor and overhead rates, prior to submission to the Naval Supply Center Pay Office. Therefore, the enforcement of the withholding provision was left to the payment office. Personnel at the payment office stated that since invoices or vouchers were reviewed and approved for payment by a COTR or DCAA, they paid the certified invoice amount of the voucher.

Based on a combination of actuals and estimates, we concluded that $7.4 million of withholdings was prematurely paid to contractors on 52 contracts at NSC, Charleston. This amount consists of $5.9 million of withholdings prematurely paid on 25 contracts and an estimate of $1.5 million of withholdings prematurely paid on the remaining 27 contracts (Appendix J).

Air Force Contract Management Division (AFCMD), Kirtland AFB, Albuquerque, New Mexico. We reviewed payments of $125 million in direct labor charges for 90 time-and-materials delivery orders. We found that $970,882 of direct labor charges was not withheld in accordance with withholding provisions in the FAR (Appendix G). This occurred because COR's or the DCAA office assigned to certify invoices were unaware of the requirement to, or were not instructed to, withhold 5 percent of the direct labor charges when reviewing contractors' vouchers. Therefore, enforcement of the withholding provisions was left to the payment office. Personnel at the payment office stated they paid the amount certified by the COR or DCAA auditor.

We projected our results to total direct labor charges valued at $1 billion on 1,677 AFCMD delivery orders issued under time-and-materials contracts. We estimated that AFCMD failed to withhold $7.9 million of labor charges (Appendix J).

Waivers of Withholding Clause. Contracting officers waived enforcement of the contract clause that required withholding 5-percent of direct labor charges without sufficient justification or merit. The FAR does not require the contracting officers to justify their decisions to grant waivers from withholding provisions. For example, our review of the six DoD

payment offices showed that almost $5 million (40 percent) of the required 5-percent withholding was waived. Details are shown in the following schedule.

Schedule of Amounts Waived at Payment Offices Reviewed

Payment Office	Amounts Required To be Withheld	Total Amounts Waived	Percent Waived
DCASR			
Army	$ 868,937	$109,825	
Navy	1,330,393	250,095	
Air Force	1,469,124	62,347	
Subtotal	$3,668,454	$422,267	11.51
NSC-Charleston	$6,305,399	$3,642,161	57.76
AFCMD-Kirtland	$ 1,861,714	$ 688,481	36.98
Totals	$11,835,567	$4,752,909	40.16

Although contracting files rarely showed any justification as to why the waiver was granted, some waivers were questionable and were granted without consideration of the risk to the Government. Examples are discussed in the following paragraphs.

On Navy contract N00189-85-D-0107, the contracting officer waived the contractual clause for withholding without stating that the contractor had performed in a satisfactory manner. However, review of the COTR files showed that the contractor was performing less than satisfactorily and, in fact, the COTR wrote the contracting officer of numerous technical deficiencies in workmanship before the contracting officer waived the required contract clause on withholding. Based on this information, we concluded that the contracting officer's decision to waive the contract clause on withholding was without merit.

On Air Force BOA F09603-86-G-0455, DCAA auditors cited the contractor's cost accounting system for at least nine Cost Accounting Standards violations over the past 8 years. Some of these violations were still outstanding before award of the 1986 BOA. If the contracting officer had enforced the required contract clause for withholding 5-percent of direct labor charges, he would have had the opportunity to lessen the Government's risk associated with these violations. Instead, the contracting officer changed the contract clause on withholding and reduced withholding from 5 percent to 1 percent with a maximum ceiling of $1,000 per order. Although the contracting

officer told us that the withholding percentage was reduced during negotiations, the contract files did not show any explanation as to why the reduction was granted.

On Air Force contract F04606-84-D-0007, a small business was awarded its first contract with the Government without any prior business record. Nevertheless, the contracting officer waived the required contract clause for withholding without any justification in the contract file.

Interpretation of the Withholding Clause. Contracting officials' varying interpretations of the contract clause for withholding contributed to the failure to withhold the required amount. For example, DLAM 8105.1, Subpart 16.601-3, requires the ACO to apply the $50,000 ceiling on each order in circumstances involving BOA's or indefinite delivery contracts. However, when using the same type of contract, the Navy required its contracting officials to apply the $50,000 ceiling on the entire contract, not the individual order.

Additionally, an audit performed by the U.S. Army Audit Agency (USAAA) showed that Army and DCASR contracting officers did not fully understand the contract clause on withholding direct labor charges for time-and-materials contracts. The USAAA asked 34 procuring and administrative contracting officers 5 basic questions relating to contract clause on withholding direct labor charges for time-and-materials contracts. Appendix L provides the detailed results of USAAA's five questions. Only 10 contracting officers were able to answer all 5 questions correctly.

Summary. Revisions to the DFARS are needed to clarify payment provisions and to establish guidance for contracting officers to adequately enforce the contract clause for withholding direct labor charges on time-and-materials contracts. Also, DCAA must perform reviews of contract clauses for withholding direct labor charges on time-and-materials vouchers. Additional checks and balances would correct the material internal control weakness found in the procedures governing payments on time-and-materials contracts. More stringent controls enforcing the contract clause for withholding direct labor charges would avoid an estimated $11.6 million in annual interest costs or as much as $69.5 million through FY 1996, if economic conditions remain constant (Appendix K).

RECOMMENDATIONS, MANAGEMENT COMMENTS AND AUDIT RESPONSE

Draft report Recommendations B.1.b., and B.2. were revised. Draft report Recommendations B.1.a, B.3.a., and B.3.b. were deleted. Draft report Recommendations B.1.b., B.1.c., and B.4. were renumbered B.1.a., B.1.b., and B.3.

Recommendation B.1.a. We recommend that the Deputy Assistant Secretary of Defense (Procurement) direct the Defense Acquisition Regulatory Council to revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require that the $50,000 ceiling on withholdings be applied to each time-and-materials order, involving Basic Ordering Agreements or indefinite delivery contracts, when orders are closed separately.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) partially concurred with this recommendation stating that the recommendation fails to reflect the legal relationship between withholdings and contractor releases. The existing contract clause provides for withholding of 5 percent of direct labor, up to a maximum of $50,000 per contract, pending receipt of the contractor's contract release. Under basic ordering agreements, each order requires a separate release and consequently a separate withholding. For indefinite delivery contracts, if orders are closed separately, then separate releases are required, and again separate withholdings. If indefinite delivery contracts do not provide for final payment and release by separate orders, then withholding by order is not appropriate. The Inspector General's recommendations, if implemented would break the existing nexus between withholdings and releases. However, the Assistant Secretary will issue a memorandum that will include a restatement of the applicability of the withholding requirement.

The Assistant Secretary of the Navy (Research, Development and Acquisition) nonconcurred, stating that the Navy's interpretation of FAR 52.232-7, "Payments Under Time-and-Materials and Labor Hour Contracts," is that the $50,000 maximum withholding limitation is not to be applied to each order issued under an indefinite delivery contract.

Audit Response. For Recommendation B.1.a., we reconsidered our position in recommending that the $50,000 ceiling on withholding be applied to each order involving indefinite delivery contracts, and we have revised this recommendation accordingly. However, the alternative action proposed by the Assistant Secretary, to issue a memorandum restating the applicability of the withholding requirement, is nonresponsive to Recommendation B.1.a. We disagree with his position that a change to the DFARS is not necessary. Our audit results provide convincing evidence of widespread noncompliance (misinterpretation) with the withholding requirement throughout the Department of Defense. In addition, historical review of contracting actions for FY's 1986 through 1989, shows a greater reliance on time-and-material contracts (a 40-percent increase in the number of contracts and a 62-percent increase in the dollar value of orders issued against those contracts). The Assistant Secretary has already agreed that a clarification in existing guidance is necessary. We believe that the results of our audit and the greater reliance on time-and-materials contracts show

that an official clarification to the existing guidance through the DFARS is warranted, to ensure overall consistency in applying the withholding requirement. Therefore, we request that the ASD (P&L) reconsider his position in responding to this recommendation in the final report.

Recommendation B.1.b. We recommend that the Deputy Assistant Secretary of Defense (Procurement) direct the Defense Acquisition Regulatory Council to revise the Defense Federal Acquisition Regulation Supplement, to add section 232.111, to require contracting officers to prepare a written justification when the percentage of withholding or application of the $50,000 ceiling is waived or limited.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) nonconcurred with this recommendation and stated that the decision on whether to waive the requirement for a 5-percent withholding is one of a large number of decisions that a contracting officer makes everyday. For all except the most important decisions, documentation requirements are not specified in the FAR or DFARS, but are instead a matter of common sense and management judgment. We cannot substitute regulatory requirements for common sense and good judgment. Therefore, it is not appropriate to specify this level of detail in the FAR or DFARS.

Audit Response. We do not agree with the ASD (P&L) comment that it is not appropriate to require the contracting officer to prepare a written justification when the percentage of withholding or the application of the $50,000 ceiling is waived or limited. The revision is needed to establish internal control procedures that will require documentation of a contracting officer's decision to waive a contractual requirement. We agree that it is the contracting officer's responsibility to exercise professional judgment as to whether a waiver should be granted. However, the need to document such a decision should not be left to the discretion of the contracting officer. As discussed in the finding, contract files rarely documented why the waivers were granted. We do not believe that contractors who submit timely final vouchers and are willing to refund amounts due the Government under paragraphs (f) and (g) of the payment clause should be subjected to withholding of payments. However, we do believe that the contracting officer should be required to document the granting of a waiver from the withholding requirement. Therefore, we believe Recommendation B.1.b. is still valid, and we request that the Assistant Secretary reconsider the position taken in response to this final report.

Recommendation B.2. We recommend that the Director, Defense Contract Audit Agency issue a memorandum to all field offices reminding them that time-and-materials vouchers approved for payment require an examination of the contract provision pertaining to the 5-percent withholding.

Management Comments. The Comptroller of the Department of Defense and the Director of the Defense Contract Audit Agency nonconcurred with draft report Recommendation B.2., which recommended a revision to DoD Directive 5105.36 that required an examination of the 5-percent withholding requirement by DCAA on time-and-materials vouchers. They stated that they opposed the recommendation because the examination of interim reimbursement vouchers by DCAA for compliance with contract provisions was adequately covered in the Contract Audit Manual paragraphs 6-1003(g), 6-1004(c), and 6-1007(c)(4). Based on the finding, DCAA intends to issue a memorandum to the field concerning the auditor's responsibility to review time-and-materials contract reimbursable vouchers for compliance with the contractual terms, including the 5-percent withholding requirement (Appendix R).

Audit Response. We agree that the Contract Audit Manual requires the DCAA auditor to ensure that time-and-materials vouchers are in compliance with the contract provisions. We have reconsidered our position and have revised this recommendation accordingly. We request DCAA to provide a date when the action will be completed in response to this final report.

Recommendation B.3. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over payments made on time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) responded to this recommendation for the Under Secretary. The Assistant Secretary nonconcurred with this recommendation and indicated there was no need to report to the Secretary of Defense on the breakdown of internal controls over payments made on time-and-materials contracts. He believed the policy memorandum described in his comments would remedy the weakness identified in the finding.

Audit Response. We disagree that the material internal control weakness cited in this recommendation will be remedied by the policy memorandum described in response to Recommendation B.1.a. The memorandum, used to restate existing policy in more detail, does not address the need to document the contracting officer's decision to waive or limit the percentage of withholding. We believe the proposed DFARS revisions would improve procedures and establish controls correcting many of the problems noted in this finding. In addition, material internal control weaknesses are reported in the period identified and tracked until the actions are completed that correct the weaknesses. Until the Assistant Secretary completes the actions to correct the weaknesses, the material internal control weakness must be reported.

DoD Directive 5010.38 states that a OSD-level material weakness (a weakness serious enough to notify the Secretary of Defense) is a problem that amounts to $2 million or more. The problems identified in the finding exceeded the $2 million criterion for reporting material weaknesses. We believe Recommendation B.3. is still valid. Therefore, we request that the Assistant Secretary reconsider the position taken and provide comments to the final report.

Finding B

Management Comments. The Navy did not agree with the potential monetary benefits. The Navy stated that the sample size was limited, the review did not differentiate between proper and improper waivers, and the calculations did not consider limits imposed by the $50,000 per contract ceiling, or other FAR clauses. The Navy asserted that the report failed to indicate if final release retentions were obtained, when discussing the contracting officers' failure to implement the required withholdings. Additionally, the Navy stated that the withholding provision in FAR 52.232-7(a)(2) should not be punitive, nor was it designed to save the Government money on a temporary basis.

Audit Response. We disagree with the Navy's comments that our sample size was limited. We reviewed 48 percent of the basic time-and-materials contracts at the Navy Supply Center, Charleston, South Carolina. Our review consisted of 67 percent of the time-and-materials contract dollar values and 84 percent of all the delivery orders issued under these basic contracts. Also, it should be noted that our review of waivers of the withholding requirement did not disclose any proper waivers, or that contracting officers were receiving final releases in a timely manner. Therefore, no differentiation could be made between proper and improper waivers.

Finally, our report neither presumes that the withholding provision is punitive in nature, nor does it presume that the clause was designed to save the Government money on a temporary basis. We believe, however, that contractors should be subjected to the withholding provisions, pending final audit, if they have not submitted timely final vouchers and have not agreed to refund any monies due the Government under paragraphs (f) and (g) of FAR clause 52.232-7, "Payments Under Time-and-Materials and Labor-Hour Contracts." Therefore, we ask that the Navy reconsider its position to the final report.

C. Surveillance of Time-and-Materials Contracts

FINDING

DoD contracting officials did not perform effective surveillance of time-and-materials contracts as required by the Federal Acquisition Regulation (FAR). Effective surveillance was not performed primarily because coordination, communication, and oversight did not exist between the individuals responsible for contract administration and surveillance functions. Surveillance plans were not prepared to describe the methods to be employed for coordinating and monitoring contractor performance and contract cost. In addition, the policies and procedures concerning the appointment and authority of technical personnel assigned to contract surveillance functions were not addressed by the Defense Federal Acquisition Regulation Supplement (DFARS). As a result, there was no assurance that the Government received the goods or services required under time-and-materials contracts. Failure to provide adequate surveillance over time-and-materials contracts is contrary to the FAR and constitutes a material internal control weakness reportable to the Secretary of Defense.

DISCUSSION OF DETAILS

Background. The Armed Services Pricing Manual, Chapter I, "Time-and-Materials Contracts," states in part that:

> Time and materials contracts provide no positive incentive for the contractor to control labor and material cost. Time and materials contracts are high-risk contracts that without extensive surveillance are susceptible to abuse. Under these contracts, the contractor can increase indirect cost absorption and profit by expending additional hours of direct labor. The contractor may also use lower-grade labor than was priced in the contract. Accordingly this may benefit the contractor in two ways. First, it can significantly increase the contractor's profit from a favorable differential in rates if the Government is charged for a higher grade labor than was actually expended on the contract. Secondly, less-skilled labor may require more hours to complete the job.

In either of the above two circumstances, the cost of direct labor to the Government unnecessarily increases. This potential hazard makes it necessary to closely monitor time-and-materials contracts to ensure that the contractor exercises proper controls.

The FAR 16.601 (b)(1) requires that the Government provide adequate surveillance on time-and-materials contracts to give reasonable assurance that efficient methods and effective cost controls are used. To ensure adequate surveillance, the contracting officer assigns various responsibilities to the DCAA auditor, the DCASR, the ACO, the COR, the COTR, and other technical personnel. The FAR describes the functions performed by the DCAA auditor and the ACO. Furthermore, the DCAA Contract Audit Manual addresses the specific duties and responsibilities of the auditor, and the Defense Logistics Agency Manual (DLAM) addresses specific functions and duties of the ACO. However, we found no description of COR, COTR, and other technical personnel responsibilities relative to the surveillance function in the FAR, DFARS, or any DoD Directives and Instructions.

The Army, Navy, and Defense Logistics Agency (DLA) have various instructions and publications providing general guidance to contracting officers on the appointment of COR's and COTR's. The Air Force does not provide guidance on the appointment or assignment of COR's and COTR's. The Army, Navy, and DLA instructions and publications provide that personnel assigned as COR's and COTR's are usually from the functional activity requesting the contract and are designated in writing by the procurement contracting officer. The designation normally defines the scope and limitation of the COR's and COTR's authority. COR's should inspect contractor operations in accordance with surveillance plans, document results, and report deficiencies to the contracting officer. When services are not provided in accordance with the contract specifications, the contracting officer should require the contractor to correct the deficiencies.

Although the FAR and DFARS do not specifically require a surveillance plan for time-and-materials contracts, the DLAM 8105.1, "Contract Administration Manual For Contract Administration Services," requires that a surveillance plan be developed for every time-and-materials contract. The plan should be developed to document a systematic approach to monitoring contractor performance, to ensure coordination between all team members, and to ensure that all team members are cognizant of their roles, as well as the roles of other team members. DLAM 8105.1, paragraph 16.601-3c, states that, as a minimum, the plan will provide for:

- a determination of the adequacy of the contractor's accounting system;

- surveillance of the contractor's operations to ensure that costs being charged to the contract are allowable, allocable, and reasonable;

- periodic on-site inspections and floorchecks and audit of the contractor's billings; and

- ensuring complete coordination, cooperation, and communication between all Government personnel concerned.

Results of Audit. We judgmentally selected 262 delivery orders valued at $203 million, issued against 57 time-and-materials contracts, to evaluate if contracting officers were establishing ceiling prices and surveillance procedures to monitor contractor performance. Although contracting officers were establishing ceiling prices for each order, they did not effectively survey 80 percent of the orders, valued at $176 million, to ensure that the level of skills contracted for was actually provided or that labor hours were reasonable and supported. In addition, on-site inspections, performed by COR's or COTR's and floorchecks, performed by DCAA auditors, were not conducted on a systematic basis. We found the major contributing factor to these conditions was that 96 percent of the delivery orders did not have a surveillance plan. Details of our review are shown in Appendix M and discussed in the paragraphs below.

Use of Surveillance Plans. ACO's did not have surveillance plans for overseeing and documenting contractor performance. Surveillance plans were not used for 251 of the 262 time-and-materials orders reviewed. DLAM 8105.1 states that it is imperative that the ACO develop a coordinated action and surveillance plan to ensure proper control of a contractor's performance. Surveillance plans become the means by which ACO's and technical personnel coordinate planned actions, such as verifying labor skills, certifying invoices, and conducting on-site inspections of the contractors' labor charging practices.

Verification of Labor Skills. The qualifications of personnel used by contractors under time-and-materials contracts were seldom verified, although their qualifications may have been the principal factor considered when awarding the contract. For instance, if the contract called for the design of a software package, the competing contractor's bid would include the qualifications of the people who would be designing the package. The education or technical qualifications of individuals listed in the bid solicitation often become the major consideration in awarding technical/engineering contracts. Our review showed that contractor proposals generally included a sample of resumes for employees expected to be used on the contract. However, contractors were allowed to substitute and add employees without submitting additional resumes for approval or identifying the names of personnel substituted or added on their billings. Thus, there was no way of ensuring that contractor personnel included in the labor charges possessed the same level of skills required by the contract.

For example, our audit entitled, "Pricing of Indefinite Delivery Contract N00019-84-D-0176 at National Systems Management Corporation," Report No. 90-018, dated December 15, 1989, showed that the contractor billed the Government for labor charges consisting of contractor personnel who were underqualified to perform the contract. Based on the results of the audit, we were able to obtain a refund of $71,000. U.S. Army Audit Agency (USAAA) reviewed two delivery orders on contract DAAB07-86-D-R001 where the names of personnel were identified on the certificates of performance. They found that, of 52 employees billed, 19 did not have resumes on file with the Government. Further review of the resumes that were on file revealed that some of the contractors' personnel did not meet the skill requirements in the contract.

Responsible personnel stated that resumes were normally reviewed during the contract selection process. Upon contract award, a coordinated surveillance plan should be designed to include periodic verification of the labor skills that the contractor charges to time-and-materials contracts. A comparison should also be made between verified labor skills and the resumes submitted during the selection process. Without periodic reviews, internal controls over time-and-materials contracts were not sufficient to detect or prevent potential labor mischarges.

Substantiation of Invoices. We evaluated public vouchers for 262 delivery orders and found that vouchers for 240 orders, valued at $179 million, were submitted for payments and paid without the required substantiation. The FAR 52.232-7(a) states that invoices for labor under time-and-materials contracts must be substantiated by the contractor with evidence of actual payment (such as employee pay stubs) and timecards, or some other form of documentation approved by the contracting officer. Our review showed that 240 invoices were not substantiated either by evidence of actual payment or by a certificate of performance prepared by the contracting officer or a designated representative.

For example, the USAAA reviewed contract DAAB07-86-D-D006, awarded for $28.8 million to provide system engineering and technical assistance, and independent verification and validation support services. Eight orders valued at $3.73 million were included in our audit sample. The contract required that each invoice be supported by a certificate of performance. As of March 1989, the Defense Contract Administration Services Region (DCASR) had disbursed about $13.2 million on invoices for services. However, no certificates of performance were attached to the contractor's invoices. The DCASR paid the invoices on this contract without substantiation by the contracting officer or a designated representative that the labor hours were reviewed. Personnel from the payment office stated they paid the invoices based on DCAA's review and approval for provisional payment. However, DCAA's reviews were limited to verifying the

appropriateness of labor and overhead rates. Discussions with contracting personnel revealed that no one was verifying the labor hours that the contractor billed. As a result, invoices were paid without any substantiation that the services had been provided.

On-site Contractor Inspections. On-site inspections and floorchecks were not conducted for 250 of the 262 time-and-materials orders reviewed. On-site inspections and periodic floorchecks are the primary means by which the Government detects whether or not it is being appropriately charged for services. The COR, COTR, and other technical personnel visited contractor facilities to see how the work was progressing from a technical standpoint. They did not perform inspections or tests of timecards to ensure that personnel included in the contractors' billings were assigned to the contract. In addition, DCAA was rarely requested to assist in, or to perform, floorchecks even though the COR/COTR appointment letter stated that DCAA's assistance would be requested. As a result, there was little assurance that personnel included in billings were actually assigned to contracts or that the hours charged were reasonable.

Clarification of Technical Personnel Responsibilities. Insufficient clarification in the DFARS of the CORs' and the COTRs' responsibilities and the contracting officer bypassing the ACO when assigning CORs' and COTRs' responsibilities contributed to ineffective surveillance of time-and-materials contracts. Appendix M shows that several surveillance functions, such as on-site visits and invoice reviews, were not performed by the ACO, the DCAA auditor, or the COR and the COTR. This occurred because each of the responsible parties perceived that the surveillance function was being performed by another party. ACO's and DCAA auditors perceived that COR's and COTR's were monitoring all contracts. The perception stems from the fact that the contracting officer delegates CORs' and COTRs' their monitoring responsibilities, bypassing the ACO who has overall contract administration responsibility. Additionally, there is no FAR or DFARS coverage of COR and COTR responsibilities for monitoring contract performance.

For example, the USAAA audit showed that the lack of understanding of roles and responsibilities contributed to poor surveillance on contract DAAB07-86-D-D006. Review showed that the responsibility for contract surveillance was split between the DCASR and an assigned COR, and that neither party verified that contractor personnel charging hours against the contract were actually working on the contract. Personnel from DCASR stated that they did not perform floorchecks or on-site inspections in order to determine the reasonableness of labor hours. Neither DCASR nor the COR certified invoices for payment. This confusion contributed to the payment of invoices

totaling about $13.2 million to be paid without assurance that labor hours were reasonable and without proper certification that the services were provided.

Oversight of Technical Personnel. Contracting officers did not effectively oversee actions taken by technical personnel assigned to monitor contract performance. For 118 of the 262 orders reviewed, the COR's, COTR's, and other technical personnel did not provide contracting officers with feedback or any evidence that surveillance functions were employed. Our review of files and our discussions with procurement officials disclosed that contracting officers rarely reviewed technical personnel performance to ensure that surveillance was performed or that COR's, COTR's and other technical personnel were not exceeding their authority. If reviews were performed, contracting officers would have found that contract administration files of the technical personnel did not contain essential information, such as copies of invoices, certificates of performance, records of inspection results, and correspondence relating to monitoring contracts performance.

For example, on contract DABT60-85-C-0520, awarded for engineering support services at the U.S. Army Signal Data Center, Fort Gordon, Georgia, the contracting officer assigned a COR located at Fort Gordon to provide technical assistance to monitor contractor performance and to ensure compliance with the conditions of the contract. Although COR's do not have contracting authority, the COR at Fort Gordon authorized the contractor over $400,000 to purchase computers and computer equipment. These purchases were made without the knowledge or approval of the contracting officer. As a result, the COR was allowed to obligate Government funds without contracting authority and without ensuring that the computers were purchased at a fair and reasonable price.

Summary. The FAR 16.601 (b)(1) requires that the Government provide adequate surveillance on time-and-materials contracts to give reasonable assurance that efficient methods and effective cost controls are used. Our review showed that surveillance over time-and-materials contracts was ineffective, even though a team approach was used to divide responsibility of surveillance functions between ACO's, DCAA auditors, and technical personnel. We agreed with this concept; however, we found that there was no oversight, coordination, or communication of team members to ensure that surveillance was performed. Therefore, we believe additional guidance should be incorporated into the DFARS, Parts 201, 202, 216 and 252, to ensure that adequate surveillance is being performed on these high risk contracts.

Specifically, surveillance plans must be required for all time-and-materials contracts to ensure that a coordinated team approach is used for overseeing and documenting contractor performance. Further, COR's, COTR's, and other technical personnel appointments, authority limitations, and responsibilities for monitoring contract performance should be clearly addressed in the DFARS as shown in Appendix N. In addition, procedures should be established to ensure that individuals tasked with surveillance of contractor performance are performing their assigned tasks. Finally, we believe that the payment of invoices without assurance that contractor personnel possessed the level of skills required by the contract and without a verification that services were provided is a material internal control weakness that should be reported to the Secretary of Defense.

RECOMMENDATIONS, MANAGEMENT COMMENTS AND AUDIT RESPONSE

Draft report Recommendations C.1.a. and C.2.b. were revised, and Recommendation C.4. was renumbered C.5. to this final report. A new Recommendation C.4. was added to this final report.

Recommendation C.1.a. We recommend that the Deputy Assistant Secretary of Defense (Procurement) direct the Defense Acquisition Regulatory Council to revise the Defense Federal Acquisition Regulation Supplement, to add section 216.601 (c)(3), to require that a time-and-materials contract be used only if the contract includes a contract surveillance plan that establishes the methods to be employed by the contract administration team, necessary for efficient and effective contract surveillance.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) partially concurred with Recommendation C.1.a. The Assistant Secretary stated that the proposed DFARS change discussed in Recommendation C.1.b. covering contracting officers' representatives should alleviate the need for this recommendation, since the responsibilities of all parties involved in surveillance functions then will be delineated in the regulations. Furthermore, the Assistant Secretary will issue a memorandum to highlight the need for adequate Government surveillance of time-and-materials contracts.

Audit Response. The Assistant Secretary's comments and planned actions satisfy the intent of Recommendation C.1.a. as worded in the draft report. However, we believe a surveillance plan would preclude duplication of efforts and provide the necessary communication and coordination between the contracting officer representative, ACO, and auditor to ensure adequate coverage of contract surveillance functions. As discussed in the finding, effective surveillance was not performed primarily because communication, coordination and oversight did not exist between individuals assigned contract administration and surveillance functions. Moreover, ACO's, DCAA auditors, and

contracting officer representatives are appointed and controlled by different organizations and their assigned functions can vary from contract to contract depending upon the type and location of the work performed. Regulations that define the roles and responsibilities of the involved parties are a positive action; however, they will not establish the methods to be employed by the various parties to effectively administer and surveil individual contracts. Therefore, we have reworded our recommendation to focus attention on requiring a surveillance plan that would establish the surveillance methods to be employed by the contract administration team. We request that the Assistant Secretary reconsider the position taken in response to Recommendation C.1.a. in his reply to this final report.

Recommendation C.1.b. We recommend that the Deputy Assistant Secretary of Defense (Procurement) direct the Defense Acquisition Regulatory Council to revise the Defense Federal Acquisition Regulation Supplement, Parts 201, 202, and 252, to address the appointment, authority, and responsibilities of contracting officer representatives, contracting officer technical representatives, and other technical personnel used to monitor contract performance. Our proposed revisions are shown in Appendix N.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) concurred with Recommendation C.1.b. and stated that the DAR Council is preparing DFARS coverage on the appointment, authority and responsibilities of contracting officer representatives. This coverage is expected to be effective early in this fiscal year.

Audit Response. The Assistant Secretary's comment may satisfy the intent of the recommendation. However, we have not been able to obtain a copy of the Defense Acquisition Regulatory Council Case No. 90-401D. Therefore, we do not know if the DFARS coverage will satisfy the intent of the recommendation. We request that the Assistant Secretary provide a copy of the proposed DFARS coverage in responding to the final report.

Recommendation C.2.a. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), Assistant Secretary of the Navy (Research, Development and Acquisition) and Assistant Secretary of the Air Force (Acquisition) require all buying activities to establish procedures to inform administrative contracting officers of contracting officer representatives, contracting officer technical representatives and other technical personnel assigned to perform surveillance of time-and-materials contracts.

Army Comments. The Army nonconcurred with Recommendation C.2.a., stating that Army Federal Acquisition Regulation Supplement already required contracting officers to distribute copies of COR designation to ACO's. Nevertheless, it will issue a reminder to contracting officers to ensure that this notification is being performed.

Audit Response. The Army's planned action satisfies the intent of Recommendation C.2.a. However, the target date for issuing the reminder was not provided in its comment. We ask that a completion date for this effort be included in the response to this final report.

Navy Comments. The Navy concurred with Recommendation C.2.a. and stated that Navy contracts identify the contracting officer representatives.

Audit Response. The Navy's comments show that its procedures already satisfy the intent of the recommendation. Additional comments to the final report are not required.

Air Force Comments. The Air Force concurred with the finding and Recommendation C.2.a., stating that it is necessary and important that time-and-materials contracts are closely monitored and properly administered and surveilled in the field. Furthermore, the Air Force agrees that additional policy is needed in this area and is presently rewriting Air Force Regulation (AFR) 400-28. This new version will establish procedures and define responsibilities for contracting officers, contracting officer technical representatives, and other technical personnel involved in the surveillance of service contracts. This action will be completed by January 1991.

Audit Response. The Air Force's comments are considered fully responsive.

Recommendation C.2.b. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), and Assistant Secretary of the Air Force (Acquisition) require all buying activities to develop procedures for conducting inspections of contracting officer representatives, contracting officer technical representatives and other technical personnel files on administration and surveillance functions to ensure that assigned tasks are being performed.

Army Comments. The Army concurred with Recommendation C.2.b., stating that Army Federal Acquisition Regulations Subpart 42.9 will be amended to require periodic inspections of COR files. The estimated date for completion of this action is October 31, 1990.

Audit Response. The Army's comment and planned action is considered fully responsive.

Navy Comments. The Navy nonconcurred with draft report Recommendation C.2.b., stating that SECNAVINST 4205.5, "Contracting Officer's Technical Representatives" dated April 18, 1988, already assigns this review responsibility to the contracting officer, delegable to the procuring activity's Procurement Management Review team.

Audit Response. Based on the Navy's comments, we reconsidered our position for Recommendation C.2.b. As a result, we have deleted the Navy from Recommendation C.2.b. and added Recommendation C.4. for the Navy to issue a memorandum to contracting officers reminding them of their responsibility to review contracting officers technical representatives files for compliance with SECNAVINST 4205.5.

Air Force Comments. The Air Force concurred with Recommendation C.2.b., stating the Air Force is currently rewriting Air Force Regulation (AFR) 400-28 to include policy on delegations, appointments, surveillance plans and documentation of surveillance performed. This action will be completed by January 1991.

Audit Response. The Air Force's planned action is considered fully responsive.

Recommendation C.3.a. We recommend that the Director, Defense Logistics Agency develop policies and procedures to prevent payments of time-and-materials contract invoices unless the invoices show verification from Government representatives that the services were provided or received.

Management Comments. DLA nonconcurred with Recommendation C.3.a., stating that the ACO's surveillance plan cannot overcome structural contractual defects that do not provide the Government with substantiation on the progress of goods and services. Time-and-materials contracts, just as with any other cost-type contract, should require the contractor to substantiate vouchers with appropriate backup data and an audit trail. Some time-and-materials contracts require that the COR/COTR sign off or attach a certification to an interim voucher before it is submitted to DCAA for approval and subsequent submission to the payment office. Other time-and-materials contracts required the submission of monthly progress reports to the contracting officer and COR/COTR as a data requirement under the contract. Inclusion of this or any other requirements regarding the substantiation that goods and services were received is an issue that can only be addressed by the contracting officer and the Military Services. Documentation of performance should be a requirement of the contract, not the surveillance plan. The ACO's surveillance plan only provides direction for Defense Contract Management Command (DCMC) personnel, not the COR/COTR and the DCAA auditors who are regulated by their own agency

requirements. Furthermore, most interim vouchers are submitted to DCAA for review and approval, and all contracts require final acceptance of the goods and services.

Audit Response. We revised Recommendation C.3.a. to clarify it. Our intent is to preclude paying unverified invoices. The audit showed that $179 million for 240 of 262 orders were paid without verification. This can only be prevented if the paying office rejects vouchers that are not verified by an authorized Government official.

Recommendation C.3.b. We recommend that the Director, Defense Logistics Agency ensure that surveillance plans are used for all time-and-materials contracts assigned to a Defense Contract Administration Office in accordance with Defense Logistics Agency Manual 8105.1, subpart 16.601.

Management Comments. DLA concurred with Recommendation C.3.b. and stated that a reminder was sent to field offices emphasizing the use of surveillance plans on time-and-materials contracts as prescribed by DLAM 8105.1, Part 16.601. See Appendix V for the complete text of DLA's comments.

Audit Response. DLA's comments and actions taken are considered fully responsive.

Recommendation C.4. We recommend that the Assistant Secretary of the Navy (Research, Development and Acquisition) issue a memorandum to contracting officers reminding them of their responsibility to inspect contracting officer technical representatives files on administration and surveillance functions in accordance with a SECNAV INST. 4205.5.

We added Recommendation C.4. to this final report based on the Navy's comment to Recommendation C.2.b. Therefore, we request that the Navy provide comments to this recommendation indicating concurrence or nonconcurrence. If the Navy concurs please describe the corrective actions taken or planned and the estimated completion date for the planned action.

Recommendation C.5. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over the surveillance of time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved.

Management Comments. The Assistant Secretary of Defense (Production and Logistics) nonconcurred with this recommendation, stating that actions planned or taken will remedy the weaknesses identified in this finding.

Audit Response. We disagree that the Assistant Secretary's actions will remedy the material internal control weaknesses identified in this finding. We believe the problems identified will not be remedied for reasons stated in our response to comments made by the Assistant Secretary and the Director of the Defense Logistics Agency on Recommendations C.1.a. and C.3.a. We also believe that the problems cited were due to noncompliance with the existing FAR requirements that deal with all programs and administration functions. Furthermore, the problems identified exceeded the $2 million criterion of reporting a material internal control weakness. It should be noted that material internal control weaknesses are reported and tracked until the actions correcting the weaknesses are completed. Until the Assistant Secretary completes his actions, the weaknesses must be reported. Therefore, we request that the Assistant Secretary reconsider his position and provide comments on the final report.

Finding C

Management Comments. DLA partially concurred, stating that it agreed that a surveillance plan should be used for time-and-materials contracts. DLA's guidance also encourages the ACO, as team leader, to convene a meeting of all DCMC functional specialists and those external specialists, such as the DCAA auditor involved in the surveillance of contract performance. The purpose of the meeting and surveillance plan is to ensure communication between the involved parties and consistent oversight of surveillance functions. DLA also agreed that policies and procedures concerning the appointment and authority of technical personnel (COR/COTR) assigned to contract surveillance functions were not addressed by the DFARS. However, DLA disagreed that it was cost-effective to perform 100-percent surveillance on monthly interim vouchers. Furthermore, it stated that adequate policies and procedures were in place for surveillance functions within DLA's scope of authority. Nevertheless, a memorandum was issued to remind all activities to comply with existing regulations.

Audit Response. We disagree that adequate policies and procedures were in place for surveillance functions within DLA's scope of authority. As discussed in the finding, 240 orders valued at $179 million were not reviewed for the accuracy and reasonableness of the hours and dollars claimed prior to payment. Most of these orders were administered and paid by DLA activities. FAR Part 42 assigns overall contract administrative responsibilities to DCASR personnel. We agree it is not always possible or cost-effective to perform 100-percent surveillance on monthly interim vouchers. Therefore, surveillance plans should be developed to describe the methods to be employed for coordinating and monitoring contractor performance and contract costs.

RESULTS OF CONTRACTS REVIEWED

Contract Number	Type of T&M Contract	Service Performed	Prior Contract Yes	Prior Contract No	Experience 1/	Training Adequate 2/ COR/COTR	Review of Historical Cost and Performance Data	Contract Type Appropriate	Contract Type Inappropriate	Contract Amount (Millions)
F0460687D0044	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	$ 4.9
F0460684D0007	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		3.9
F3365785D2191	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		1.3
F3360084D0280	Task Order	Engineer	x		Inadequate	Adequate	Adequate		X	1.0
F3360087D0337	Task Order	Engineer	x		Inadequate	Adequate	Inadequate		X	.3
F4160887D0203	Task Order	Engineer	x		N/A 3/	N/A 3/	N/A 3/	X		.7
F3365785D2192	Task Order	Engineer		x	Inadequate	Inadequate	Inadequate	X		5.4
F0460684D0048	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	5.1
F0460686D0040	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	2.1
F4160887D0216	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	2.0
F4160886D0010	Task Order	Engineer		x	Inadequate	Inadequate	Inadequate	X		15.9
F0460686C0056	Task Order	R&M 4/	x		Inadequate	Inadequate	Inadequate		X	2.2
F0960385G0867	BOA 5/	Engineer	x		Inadequate	Inadequate	Inadequate		X	.3
F0960386G0455	BOA 5/	Engineer	x		Inadequate	Inadequate	Inadequate		X	20.0
F0965085G0001	BOA 5/	Engineer	x		Adequate	Inadequate	Adequate		X	1.1
F0960385G0681	BOA 5/	Engineer	x		Inadequate	Adequate	Adequate		X	13.4
F0960386G0954	BOA 5/	Engineer		x	Inadequate	Adequate	Inadequate		X	7.1
F0960384G3254	BOA 5/	Engineer	x		Inadequate	Inadequate	Inadequate		X	6.3
F0960387G0424	BOA 5/	R&M 4/	x		Inadequate	Inadequate	Inadequate		X	1.4
F4160881G0046	BOA 5/	R&M 4/	x		Adequate	Inadequate	Inadequate		X	6.4
F0960385G1306	BOA 5/	R&M 4	x		Inadequate	Inadequate	Inadequate		X	3.2
F0460687C0137	Basic T&M	R&M 4		x	N/A 3/	N/A 3/	N/A 3/	X		2.9
DAAK0186DC071	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		3.7
DAAA2186D0031	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	1.1
DAAA2187D0022	Task Order	Engineer	x		Adequate	Adequate	Inadequate		X	5.5
DAAB0785DF018	Task Order	Engineer	x		Adequate	Adequate	Inadequate		X	11.0
DAAB0786DR001	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	16.8
DAAB0786DL066	Task Order	Engineer		x	Adequate	Inadequate	Inadequate	X		1.8
DAAA2185D0010	Task Order	Engineer	x		Adequate	Adequate	Adequate	X		3.9
DAAB0786DD006	Task Order	Engineer	x		Adequate	Adequate	Inadequate		X	4.9
DAAA2187D0025	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	.2
DAAJ0983DA015	Task Order	R&M 4/	x		N/A 3/	N/A 3/	N/A 3/	X		.1
DAAA2187D0003	Task Order	R&M 4/	x		Inadequate	Adequate	Inadequate		X	.2

RESULTS OF CONTRACTS REVIEWED (Continued)

Contract Number	Type of T&M Contract	Service Performed	Prior Contract Yes	Prior Contract No	Experience 1/	Training Adequate 2/ COR/COTR	Review of Historical Cost and Performance Data	Contract Type Appropriate	Contract Type Inappropriate	Contract Amount (Millions)
DAAB0787DF033	Task Order	R&M 4/	x		Adequate	Inadequate	Inadequate		X	$ .8
DABT6087C4098	Basic T&M	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		2.0
DABT6085C0520	Basic T&M	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		3.4
DAAB0787CJ001	Basic T&M	Engineer	x		Adequate	Adequate	Inadequate		X	1.7
DABT6087G2438	BOA 5/	Engineer		x	Adequate	Inadequate	Inadequate	X		.5
M0002782D0018	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	.9
M0002787D0029	Task Order	Engineer	x		Inadequate	Inadequate	Inadequate		X	.7
N0018983D0011	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	.7
N0018985D0107	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		4.6
N0001987D0074	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	1.6
N0001984D0117	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	4.4
N0001987D0191	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	3.9
N0001985D0520	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	1.5
N0012386D0295	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	.1
N0001987D0098	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	1.9
N0018984D0010	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		4.4
N0001984D0176	Task Order	Engineer		x	N/A 3/	N/A 3/	N/A 3/	X		5.5
N0018986D0408	Task Order	R&M 4/	x		Adequate	Inadequate	Inadequate		X	7.7
N0018987D0352	Task Order	R&M 4/	x		Adequate	Inadequate	Inadequate		X	1.3
N0018987D0096	Task Order	R&M 4/	x		Adequate	Inadequate	Inadequate		X	.4
N6226986D0107	Task Order	R&M 4/	x		Adequate	Inadequate	Adequate		X	8.6
N0012385D0070	Task Order	R&M 4/	x		Adequate	Inadequate	Inadequate		X	.1
N6226987C0004	Basic T&M	R&M 4/	x		Adequate	Inadequate	Inadequate		X	.1
N6226986D0124	Task Order	Engineer	x		Adequate	Inadequate	Inadequate		X	1.2
Total	42=Task Orders 10=BOA's 5=Basic T&M Contracts				27=Adequate 19=Inadequate	10=Adequate 36=Inadequate	5=Adequate 41=Inadequate	16	41 6/	$214.1
								57		

1/ Experience considered adequate if the Procurement Contracting Officer had experience issuing other types of contracts.
2/ Training was considered inadequate if Contracting Officer Representative (COR) or Contracting Officer Technical Representative (COTR) did not attend a formal training course.
3/ N/A indicates that remarks are not applicable because the contract was accepted as appropriately awarded.
4/ Repairs and Maintenance (R&M).
5/ Basic Ordering Agreements (BOA's) were considered inappropriately awarded when structured to prevent various pricing arrangements.
6/ Dollar total of inappropriately awarded contracts is $154.6 million.

SAMPLING METHODOLOGY AND CALCULATIONS FOR SELECTING AND EVALUATING TIME-AND-MATERIALS CONTRACTS

The sampling objective was to obtain a representative sample of time-and-materials contracts and project the audit results over the universe of the DoD time-and-materials contracts. As shown below, the sample universe, developed by the Quantitative Methods Division (QMD) of the Office of the Inspector General for Auditing, DoD, was divided into three strata based on the value of FY 1987 contracts. The universe represents 1,234 contracts, and a sample of 57 contracts was selected for review. The results from our sample are expressed at a 90-percent confidence level with a relative precision of estimate of the dollars of ± 32 percent.

	Universe	Strata 1	Strata 2	Strata 3
Number of Purchasing Offices	190	36	26	128
Number of Contracts	1,234	871	148	215
Value	$1,413,642	$1,128,981	$155,071	$129,590

	Sample	Strata 1	Strata 2	Strata 3
Number of Purchasing Offices	16	6	5	5
Number of Contracts	57	37	12	8
Value	$195,871	$152,805	$37,833	$5,233

Special Considerations

The original universe was developed using FY 1987 data included in the Individual Contracting Action Report, DD Form 350. QMD adjusted the original universe in order to eliminate research and development contracts.

Calculation for Inappropriately Awarded Time-and-Materials Contracts

We estimated that $1 billion of the currently open time-and-materials contracts in our audit universe was awarded without adequate analysis or justification based on the following calculation.

(1) Dollar value of contracts reviewed not appropriately awarded divided by dollar value of contracts reviewed, equals percent of dollars not appropriately awarded.

$$\frac{\$154.6 \text{ million}}{\$214.1 \text{ million}} = 72.2 \text{ percent}$$

(2) Dollar value of audit universe multiplied by the percent of dollars not appropriately awarded equals the estimate of dollars not appropriately awarded.

$1,413,642,000
x .722
$1,020,650,000

FINAL REPORT DISTRIBUTION

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Director, Defense Contract Audit Agency
Director, Defense Logistics Agency

DEPARTMENT OF THE NAV
NAVAL SUPPLY SYSTEMS COMMAND
WASHINGTON D C 20376-5000

TELEPHONE NUMBER
COMMERCIAL
AUTOVON
IN REPLY REFER TO:
4284.2
02219/JPT

JUN 10 1990

From: Commander, Naval Supply Systems Command
To: Commanding Officer, Naval Supply Center, Norfolk

Subj: BUSINESS CLEARANCE NF-10425

Ref: (a) Telecon NSC G. Holtzmiller/NAVSUP J. Trader of 5/24/88
(b) Telecon NSC S. McClain/NAVSUP J. Trader of 1 June 88

1. On 7 April 88, the subject clearance was conditionally approved contingent upon verification of cost realism prior to requesting "best and final" offers and submission of such cost realism documentation for all three offerors to NAVSUP for review. If cost realism analysis is considered acceptable by NAVSUP, post negotiation clearance may be waived at that time. Prior to conditional approval, NAVSUP 022 and 02219 traveled to NSC Norfolk to discuss the subject clearance. A list of specific areas of concern was provided on 16 & 17 March 88. Resolution of these concerns must be provided.

2. On 12 May 88, the subject clearance was resubmitted and approval was granted with the understanding that Clause B22 Certification of Manhours would be deleted and the contract would be a fixed rate Time and Materials contract. Authority to hold discussions and request Best and Final Offers was granted.

Reference (a) communicated your desire to make award on a CPFF basis. While the situation may dictate the use of a CPFF type contract, it should be noted that the preferred method at ASN is T&M. In the instant procurement the best way to an expedient award may well be the T&M.

3. Irrespective of the contract type, the solicitation and the evaluation factors will require significant revisions and the post negotiation business clearance must clearly address the following:

a. Restructure the solicitation to remove Clause B22 Certification of Manhours.

b. Develop an evaluation plan to include more than personnel/corporate experience. As a minimum, require a management plan, management approach and sample task to evaluate technical understanding.

c. Restructure the source selection plan to provide evaluation factors for Understanding of Technical Approach. Remove the additional points for experience beyond the minimum requirements.

d. Revisit restrictiveness of Section C15 Facilities- (a) "the contractor shall maintain a primary facility within one half hour", and (b) "It is anticipated that the following core of contractor personnel shall be located at the Norfolk facility." What is the justification for one half hour restriction? Who pays for the 33 core personnel? Do you plan to issue a Delivery Order to cover the yearly requirements? Consideration should be made as to the validity of these requirements.

e. Delete the requirement under Section L12a for submission of actual labor rates for proposed personnel (in accordance with clause B22A).

f. Under Section H57, Continuity of Services, there is a requirement for phase-in and phase-out services up to 90 days after this contract expires. However, Section B does not provide a separate line item for these services. How will evaluation be made under this competitive solicitation and equally important - how does the contractor obtain payment without a separate line item?

g. Provide evidence that payment of fixed fee as set forth in B15 is equitably reflective of the labor hours expended. Accumulating the 15% withhold can be administratively cumbersome and poses potential cash flow problems for contractors.

h. Provide cost realism analysis on each contractors' proposal to establish that the proposed cost is commensurate with the effort. A comparison of contractors' labor rates to the subjective government employee equivalents does not serve this purpose. Techniques for evaluating labor rates can be found in Chapter 7 of the Armed Services Pricing Manual.

4. Caution should be exercised when developing the evaluation criteria. To the extent that criteria are made "mandatory", "minimum requirements", or nonnegotiable issues (e.g., "offeror

shall demonstrate a minimum of ___x__ years corporate experience," "must possess a model __x___ printer") they approach standards of responsibility in accordance with FAR 9.104-1(e) rather than technical acceptability. NAVSUPINST 4200.79A provides policy and procedures concerning the evaluation and selection of sources for competitive acquisitions.

5. This confirms reference (b).

6. The Naval Supply Systems Command point of contact in this matter is Ms. Jane Trader, SUP 02219, at (202) 695-5045 or Autovon 225-5045.

N. G. REICH
By Direction

SCHEDULE OF PROFIT ANALYSIS ON TEN CONTRACTS

Contract Number	Contract Value (millions) [1]	Profit (Percentage) [2]
F04606-84-D-0048 [3]	$ 18.0	12.64
F09603-85-G-1306 [3]	9.5	28.52
F09603-86-G-0455 [3]	42.5	26.28
F09603-85-G-0681 [3]	27.8	18.95
N00189-83-D-0011 [3]	9.0	23.18
N00189-86-D-0408 [3]	37.9	17.35
N00123-86-D-0295 [3]	28.0	18.19
N00189-85-D-0107 [3]	13.4	13.96
N00019-84-D-0176 [4]	17.0	20.40
DAAK01-86-D-C071 [3] [4] [5]	6.9	12.10
Total	$210.0	

1/ Ten contracts were judgmentally selected for review to determine profit earned on labor.

2/ Profit percentage earned on labor averaged 19.16 percent.

3/ Review of contractor costs was performed by the Defense Contract Audit Agency.

4/ Review of contractor costs was performed by the Department of Defense Inspector General.

5/ Defense Contract Audit Agency review disclosed that the prime contractor did not maintain employee time cards. Therefore, our review was performed on the subcontractor.

SAMPLING METHODOLOGY FOR TESTING THE 5-PERCENT WITHHOLDING PROVISION

Sample Objective

We requested that the nine Defense Contract Administration Services Regions (DCASR's), the Air Force Contract Management Division (AFCMD), and the Naval Supply Center, Charleston, South Carolina, provide payment data for all active time-and-materials contracts and delivery orders paid by their payment offices. The payment data is shown below:

Activities	Contracts	Contract Action	Value (Millions)
Naval Supply Center	52	0	$ 363.2
Air Force Contract Management Division	0	1,677	1,288.4
Defense Contract Administration Services Regions	0	12,298	6,971.6
	52	13,975	$8,623.2

Estimate Process

We chose a 3 stage cluster sample from the universe. At the first stage, we chose 4 DCASRs at random. Among the sampled DCASR's, contracts were grouped into strata by activity (Army, Navy, Air Force, and DLA). Within activities, contracts were randomly sampled within four dollar strata. Examination of the sampled actions and contracts in the field revealed that some were not time-and-materials contracts, even though they were classified as such in the DCASR's Mechanization of Contract Automated Systems. This accounted for the difference between the revised number of actions (12,298) and the original number of actions (13,795). This same process was repeated at AFCMD; however, there were no misclassified time-and-materials contracts. The overall relative precision of estimate of the dollars is ± 40 percent with 90% confidence. See Appendix F for adjustments to the sample universe.

SCHEDULE OF CONTRACT ACTIONS
SAMPLED AT DCASR'S 1/ AND AFCMD 2/, KIRTLAND AFB 3/

Air Force	Original Universe		Original Sample		Adjustments to Sample		Adjusted Sample	
	Contract Action	Amount (millions)	Contract Action	Amount (millions)	Contract Action	Amount (millions)	Contract Action	Amount (millions)
AFCMD-Kirtland AFB	1,677	$1,288.4	90	$158.3	0	0	90	$158.3
DCAS Region								
Philadelphia	4,714	$1,234.4	103	$ 77.5	11	$18.1	92	$ 59.4
Los Angeles	2,365	1,273.2	99	87.9	8	15.4	91	72.5
Boston	1,838	615.7	109	34.0	19	5.8	90	28.3 4/
New York	1,611	1,384.3	76	48.4	6	13.9	70	34.5 4/
Total Sampled	10,528	$4,507.6	387	$247.8	44	$53.2	343	$194.7

1/ Defense Contract Administration Services Regions (DCASR's).
2/ Air Force Contract Management Division (AFCMD).
3/ Air Force Base (AFB).
4/ Slight variance due to rounding.

RESULTS OF 5-PERCENT WITHHOLDING AT PAYMENT OFFICES REVIEWED

Service	DCASR Region 1/ or Payment Office	Contract Actions	Labor Amount (000)	Required 5-Percent Withholdings (000)	Actual Amount Withheld (000)	Amounts Not Withheld (000)	Percent Not Withheld
Army	Philadelphia	27	$ 6,013	$ 254 2/	$ 168	$ 86	34
	Los Angeles	35	7,796	384 2/	55	329	86
	New York	11	2,700	121 2/	14	107	89
	Boston	6	2,018	101	17	84	83
	Subtotal	79	$18,527	$ 860	$ 254	$ 606	
Navy	Philadelphia	30	$ 5,244	$ 262	$ 179	$ 83	32
	Los Angeles	39	10,442	482 2/	110	372	77
	New York	37	3,816	191	0	191	100
	Boston	62	11,137	394 2/	271	123	31
	Subtotal	168	$30,639	$1,329	$ 560	$ 769	
Air Force	Philadelphia	35	$15,008	$ 495 2/	$ 380	$ 115	23
	Log Angeles	17	18,880	373 2/	171	202	54
	New York	22	8,726	388 2/	0	388	100
	Boston	22	4,250	213	95	118	55
	Subtotal	96	$46,864	$1,469	$ 646	$ 823	
	DCASR Totals 3/ 4/	343 5/	$96,030	$3,658	$1,460	$2,198	60
	NSC-Charleston SC Totals 3/	25	$145,369	$6,305	$ 387	$5,918	94
	AFCMD-Albuquerque Totals 3/	90	$125,363	$1,862	$ 891	$ 971	52

1/ Defense Contract Administration Services Region.

2/ Required withholdings are limited to the $50,000 ceiling where applicable.

3/ Review of the Defense Contract Administration Services Regions and Air Force Contract Management Division Albuquerque, New Mexico, was based on individual delivery orders. Review of the Naval Supply Center (NSC) Charleston, South Carolina, was based on the basic contract.

4/ Minimal dollar discrepancies are found in totals for DCASR's due to rounding.

5/ Total value of 343 delivery orders was $195 million.

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

4 MAR 1988

DLA-ACM

SUBJECT: DLA-ACM Letter No. AC-88-14, Administration of Time and Materials (T & M) Contracts Regarding FAR Clause 52.232-7

TO: Commanders of DCAS Regions
ATTN: Directors, Contract Management

This letter is directive in nature and expires on 2 March 1989 unless sooner superseded or rescinded. This letter should be circulated to Region and field personnel in the following organizational code: AC.

1. Reference: DCASR PHI-A letter dated 8 Feb 88, subject: Administration of Time and Materials (T & M) Contracts.

2. Referenced letter (enclosure 1) raised questions regarding (1) the percentage of withholding and (2) the $50,000 withholding ceiling, included in the clause at FAR 52.232-7, "Payments under Time-and-Materials and Labor-Hour Contracts." In reply, this letter provides policy guidance in addressing these two concerns.

3. The first question (contained in paragraph 2 of referenced letter) was whether there were any limits on the Procuring Contracting Officer's (PCO's) discretionary authority to alter the percentage of withholding contained in subject clause. In response, we find no limits on the PCO's authority in this instance. When the PCO exercises authority to vary the percentage of withholding from the standard 5 percent called for in the clause, the amount of withholding can be whatever the PCO deems both prudent and reasonable under the instant circumstances, and that both contractual parties agree to in the contract. In cases where an Administrative Contracting Officer (ACO) has questions concerning the rationale for a certain percentage of withholding we strongly encourage the ACO to contact the PCO to gain an understanding regarding why a certain percentage was chosen.

4. The second concern (expressed in paragraph 3 of referenced letter) pertained to whether the $50,000 maximum withholding limitation should be applied to each T & M order individually or to the aggregate total of all T & M orders issued under the basic instrument. With respect to orders issued under a Basic Ordering Agreement (BOA), the withholding limitation would apply to each individual T & M order issued under a BOA, since the BOA itself is not a contract. With regard to T & M orders issued under

SUBJECT: DLA-ACM Letter No. AC-88-14,
Administration of Time and Materials (T & M) Contracts
Regarding FAR Clause 52.232-7

Indefinite Delivery Type Contracts (IDTCs) the answer is not as clearcut. However, the past practice of both industry and Government appears to be that the terms and conditions of T & M contracts should be applied to the order itself and not to the contract as a whole. Accordingly, this guidance should be followed by ACOs, and the withholding provisions of subject clause should be applied per order for T & M orders under both BOAs and IDTCs. For a more detailed explanation of the reasoning for this position, contract administration personnel should contact their local Office of Counsel which has already been provided a copy of the DLA Office of General Counsel legal opinion on this subject.

5. Questions on this letter should be directed to CDR Mitchell, DLA-ACM, AV 284-7644. Guidance contained herein will be included in the next change to DLAM 8105.1.

FOR THE DIRECTOR:

Encl

WILLIAM V. GORDON
Executive Director
Contract Management

DEPARTMENT OF THE NAVY
NAVAL SUPPLY SYSTEMS COMMAND
WASHINGTON D.C. 20376-5000

TELEPHONE NUMBER
COMMERCIAL
AUTOVON
IN REPLY REFER TO

7200
021A/FEW
89-23

13 JAN 1989

From: Commander, Naval Supply Systems Command

Subj: WITHHOLDING OF PAYMENT UNDER TIME-AND-MATERIALS AND LABOR-HOUR CONTRACTS

Ref: (a) NRCC Wash letter of 30 Nov 88

1. Reference (a) provided an excellent request for clarification from NRCC Washington. This request concerned FAR 52.232-7, Payments under Time-and-Materials and Labor-Hour Contracts, which requires the contracting officer to withhold from payment 5 percent of the amounts due, but the total amount withheld shall not exceed $50,000. It was unclear if this 5 percent and $50,000 withholding amount applies per payment or the total contract amount. The following clarification applies:

The 5% withholding applies to <u>each payment</u>.

The $50,000 withholding amount is the total cumulative amount (adding the total of all 5% withholdings) which can be withheld for the <u>entire contract</u>. Options exercised under a contract are to be treated as a new contract for applying FAR 52.232-7. Accordingly, the withholding of 5% from the first payment under the option will again begin the cumulative withholdings not to exceed $50,000.

2. Any questions or comments concerning this issue may be directed to Elaine Wheeler on autovon 225-5256 or commercial (202) 695-5015.

3. Procurement Management Review Divisions and Detachments are requested to further disseminate this information as appropriate within their respective regions.

[illegible]
By direction

Walton Hackman
Division Director of Policy

Distribution:
List "C"

PROJECTIONS OF PREMATURELY PAID DIRECT LABOR CHARGES

FAR 53.232-7(a), "Payment Under Time-and-Materials and Labor Hour Contracts," requires that 5 percent of invoiced direct labor charges (up to a maximum of $50,000 per contract) be withheld until the contractor executes and delivers a release and the Government performs a final audit of the contract cost.

For the nine Defense Contract Administration Services Regions (DCASR'S), we estimated that $109 million of labor charges were not withheld based on the following calculations.

(1) For the 343 delivery orders reviewed, the statistical estimate of the required 5-percent withholding (limited to the $50,000 ceiling where applicable) divided by the total direct labor charges, equals the percent of dollars that should have been withheld.

$$\frac{\$\ 38,357,180}{\$881,828,273} = 4.35 \text{ percent}$$

(2) The total direct labor charges of the audit universe (12,298 delivery orders), multiplied by the percent of dollars that should have been withheld, equal the projected dollars that should have been withheld.

$$\begin{array}{r} \$4,402,409,284 \\ \times \quad .0435 \\ \hline \$\ \ 191,504,804 \end{array}$$

(3) For the 343 delivery orders reviewed, the statistical estimate of the amounts not withheld divided by the required 5-percent withholdings, equal the percent of dollars not withheld.

$$\frac{\$21,859,870}{\$38,357,180} = 56.99 \text{ percent}$$

(4) The projected dollars that should have been withheld, multiplied by the percent of dollars not withheld, equal the projected dollars not withheld.

$$\begin{array}{r} \$191,504,804 \\ \times \quad .5699 \\ \hline \$109,138,588 \end{array}$$

For Naval Supply Center (NSC) we estimated, that $7.4 million of labor charges was not withheld based on the following calculations.

(1) For the 25 contracts reviewed, the required 5-percent withholding (limited to the $50,000 ceiling where applicable) divided by the total direct labor charges, equals the percent of dollars that should have been withheld.

$$\frac{\$\ \ 6.305 \text{ million}}{\$145.369 \text{ million}} = 4.3 \text{ percent}$$

(2) The total direct labor charges of the audit universe (52 contracts), multiplied by the percent of dollars that should have been withheld, equal the estimated dollars that should have been withheld.

$182,300,093
x .043
$ 7,838,904

(3) For the 25 contracts reviewed, the amounts not withheld divided by the required 5-percent withholdings equal the percent of dollars not withheld.

$\frac{\$5,918,000}{\$6,305,000}$ = 93.9 percent

(4) The estimated dollars that should have been withheld multiplied by the percent of dollars not withheld equal the estimated dollars not withheld.

$7,838,904
x .939
$7,360,731

For Air Force Contract Management Division (AFCMD), we estimated that $7.9 million of labor charges was not withheld based on the following calculations.

(1) For the 90 delivery orders reviewed, the required 5-percent withholding (limited to the $50,000 ceiling where applicable) divided by the total direct labor charges, equal the percent of dollars that should have been withheld.

$\frac{\$\ 1.862 \text{ million}}{\$125.363 \text{ million}}$ = 1.485 percent

(2) The total direct labor charges of the audit universe (1,677 delivery orders), multiplied by the percent of dollars that should have been withheld, equal the projected dollars that should have been withheld.

$1,019,266,473
x .01485
$ 15,136,107

(3) For the 90 delivery orders reviewed, the amounts not withheld divided by the required 5-percent withholdings equal the percent of dollars not withheld.

$\frac{\$\ 971,000}{\$1,862,000}$ = 52.1 percent

(4) The projected dollars that should have been withheld multiplied by the percent of dollars not withheld equal the projected dollars not withheld.

$15,136,107
x .521
$ 7,885,912

Summary of Prematurely Paid Direct Labor Charges

Organization	Projected* Amount
DCASR	$109,138,588
NSC	7,360,731
AFCMD	7,885,912
	$124,385,231

*This projection has relative precision of estimate of ± 40 percent of the dollars with 90 percent confidence. Also, the projection was made from audit data sampled only in the last six months of the audit period (1987). It assumed that activity in the first six months is simular to activity in the last six months so that projection for the year is simply two times that of the six months audited. The $124.4 million is therefore, the annualized amount projected as prematurely paid.

CALCULATIONS OF INTEREST EXPENSE INCURRED BY THE U.S. TREASURY

We calculated interest expense of $69.5 million that could be avoided over the next 6 years if DoD enforced the FAR 5-percent withholding provisions under Time-and-Materials and Labor Hour Contracts. We did not calculate interest associated with Labor Hour Contract provisions. Our computations are based on a simple annual interest rate applied to the principal. The simple annual interest rate was derived from a weighted average of the Secretary of the Treasury's Current Value of Funds Rates used to assess interest charges for outstanding debts on claims owed to the Government. The principal is premature payments of direct labor charges shown in Appendix J. We assumed that the level of payments on time-and-materials contracts would remain constant and that economic conditions would remain the same. Also, we assumed that the premature payments were in the hands of the contractor for an average of 1 year and that time-and-materials contracts were initiated, paid and closed at a constant rate commensurate with our audit sample.

For the nine Defense Contract Administration Service Regions, we calculated that the Government could avoid $9.5 million of annual interest expense by enforcing the FAR 5-percent withholding provisions on time-and-materials contracts. Details are:

$109,138,588	Direct Labor Charges not Withheld
x .09313	Simple Annual Interest Rate
$ 10,164,077	Annual Interest Expense

For the Naval Supply Center (NSC), Charleston, South Carolina, we calculated that the Government could avoid $685,504 of annual interest expense by enforcing the FAR 5-percent withholding provisions on time-and-materials contracts. Details are:

$7,360,731	Direct Labor Charges not Withheld
x .09313	Simple Annual Interest Rate
$ 685,504	Annual Interest Expense

For the Air Force Contract Management Division, we calculated that the Government could avoid $734,415 of annual interest expense by enforcing the FAR 5-percent withholding provisions on time-and-materials contracts. Details are:

$7,885,912	Direct Labor Charges not Withheld
x .09313	Simple Annual Interest Rate
$ 734,415	Annual Interest Rate

CALCULATIONS OF INTEREST EXPENSE INCURRED BY THE U.S. TREASURY (Continued)

Projection:

	Annual Interest Expense	Projected x Years	=	Interest Expense Avoided
DCASR's	$10,164,077	6		$60,984,462
NSC, Charleston, SC	685,504	6		4,113,024
AFCMD	734,415	6		4,406,490
Totals	$11,583,996	6		$69,503,976

U.S. ARMY AUDIT AGENCY QUESTIONNAIRE OF 5-PERCENT WITHHOLDING REQUIREMENT

Questions	Responses	
	Correct	Incorrect
1. Are you aware that time-and-materials contracts have a withholding requirement?	28	6
2. How much should be withheld?	14	20
3. What is the ceiling for withholding funds?	15	19
4. Does the ceiling apply to each delivery order or the contract in total?	19	15
5. When should funds be released?	22	12

The above listed questions were asked of 34 procuring and administrative contracting officers at the U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey. Only 10 of the 34 were able to answer all 5 questions correctly. The procuring contracting officers only answered 34 percent of the questions correctly, while administrative contracting officers answered 72 percent of the questions correctly. The questions were taken from information provided in FAR clause 52.232-7, "Payments Under Time-and-Materials Contracts."

SUMMARY OF SURVEILLANCE OF TIME-AND-MATERIALS CONTRACTS

Contract Number By Activity	Orders Reviewed 1/		Inadequate Surveillance Plan 2/		Inadequate Site Visits 3/		Inadequate Invoice Review 4/		Inadequate Progress Reports 5/		Inadequate COR/COTR Feedback 6/	
	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)
Army	141	$ 46.55	138	$ 46.22	137	$45.55	134	$ 45.03	89	$ 21.38	9	$ 6.29
Navy	69	23.93	67	23.43	66	21.26	62	21.70	56	18.68	57	19.15
Air Force	52	132.75	46	129.16	47	119.63	44	112.70	43	118.23	52	132.75
Grand Totals	262	203.23	251 7/	198.81	250	186.44	240	179.43	188	158.29	118	158.19

1/ Based on a weighted average of the attributes, we determined that 209 of the 262 orders reviewed (80 percent) were ineffectively surveyed by contracting officials. The weighted average value of the 209 orders was $176.3 million.

2/ A surveillance plan should be developed in order to document a systematic approach for monitoring contractor performance and cost.

3/ A floorcheck represents the actual on-site observation of contractors' employees performing under the contract and includes reviews of timecards/timesheets or labor distribution schedules to ensure that the proper charging of time is taking place.

4/ Invoices were not reviewed for the accuracy and reasonableness of the hours and dollars claimed prior to submission by the contractor to the payment office.

5/ Progress reports indicate the progress and status of work, possibility of future technical or financial difficulties and can be used to award firm-fixed-priced contracts for similar types of work or follow on requirements.

6/ COR/COTR feedback represents written evaluations of contractor performance prepared by the CORS/COTRS and submitted to the contracting officer.

7/ We determined that 96 percent of the surveillance plans was inadequate (251 inadequate plans divided by the 262 orders reviewed).

SUMMARY OF SURVEILLANCE OF TIME-AND-MATERIALS CONTRACTS (continued)

ARMY

Contract Number By Activity	Orders Reviewed 1/		Inadequate Surveillance Plan 2/		Inadequate Site Visits 3/		Inadequate Invoice Review 4/		Inadequate Progress Reports 5/		Inadequate COR/COTR Feedback 6/	
	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)
USA Troop Support Command, St. Louis, MO												
DAAK01-86-D-C071	4	$ 1.83	4	$ 1.83	4	$ 1.83	4	$ 1.83	4	$ 1.83	4	$1.83
DAAJ09-83-D-A015	1	.30	1	.30	1	.30	1	.30	1	.30	1	.30
USA-Training Support Center Ft. Eustis, VA												
DABT60-85-C-0520	3	3.99	3	3.99	3	3.99	3	3.99	3	3.99	3	3.99
DABT60-87-G-2438	4	.50	1	.17	1	.17	1	.17	1	.17	1	.17
DABT60-87-C-4098	1	.67	1	.67	0	0	0	0	0	0	0	0
USA-Communications-Electronics Command, Ft Monmouth, NJ												
DAAB07-86-D-R001	13	9.64	13	9.64	13	9.64	13	9.64	0	0	0	0
DAAB07-86-D-L066	8	1.72	8	1.72	8	1.72	8	1.72	8	1.72	0	0
DAAB07-86-D-A035	13	4.01	13	4.01	13	4.01	13	4.01	0	0	0	0
DAAB07-86-D-D006	8	3.73	8	3.73	8	3.73	8	3.73	8	3.73	0	0
DAAB07-87-D-F033	1	.38	1	.38	1	.38	1	.38	1	.38	0	0
DAAB07-87-C-J001	1	1.65	1	1.65	1	1.65	1	1.65	1	1.65	0	0
USA-Picatinny Arsenal, NJ												
DAAA21-86-D-0031	20	1.69	20	1.69	20	1.69	20	1.69	20	1.69	0	0
DAAA21-87-D-0022	19	10.00	19	10.00	19	10.00	19	10.00	0	0	0	0
DAAA21-87-D0025	19	4.73	19	4.73	19	4.73	19	4.73	19	4.73	0	0
DAAA21-85-D-0010	3	.52	3	.52	3	.52						
DAAA21-87-D-0003	23	1.19	23	1.19	23	1.19	23	1.19	23	1.19	0	0
Total	141	$46.55	138	$46.22	137	$45.55	134	$45.03	89	$21.38	9	$6.29

FOOTNOTES ARE ON PAGE 1 OF 4, APPENDIX M.

SUMMARY OF SURVEILLANCE OF TIME-AND-MATERIALS CONTRACTS (Continued)

NAVY

Contract Number By Activity	Orders Reviewed 1/		Inadequate Surveillance Plan 2/		Inadequate Site Visits 3/		Inadequate Invoice Review 4/		Inadequate Progress Reports 5/		Inadequate COR/COTR Feedback 6/	
	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)
Naval Air Systems Command, Washington, DC												
N00019-84-D-0176	6	$1.40	6	$1.40	6	$1.40	6	$1.40	6	$1.40	6	$1.40
N00019-87-D-0074	1	.70	1	.70	1	.70	1	.70	0	0	1	.70
N00019-84-D-0117	7	1.23	7	1.23	7	1.23	7	1.23	7	1.23	7	1.23
N00019-87-D-0191	4	.35	4	.35	4	.35	4	.35	0	0	4	.35
N00019-85-D-0520	2	.50	0	0	2	.50	2	.50	0	0	2	.50
N00019-87-D-0098	1	.20	1	.20	1	.20	1	.20	1	.20	1	.20
US Naval Supply Center, Norfolk, VA												
N00189-85-D-0107	3	2.01	3	2.01	3	2.01	3	2.01	3	2.01	3	2.01
N00189-87-D-0352	2	.93	2	.93	2	.93	0	0	0	0	2	.93
N00189-87-D-0096	3	.27	3	.27	3	.27	3	.27	3	.27	3	.27
N00189-86-D-0408	10	4.40	10	4.40	10	4.40	10	4.40	10	4.40	0	0
N00189-84-D-0010	5	1.30	5	1.30	4	1.02	0		5	1.30	5	1.30
N00189-83-D-0011	5	.27	5	.27	5	.27	5	.27	5	.27	5	.27
US Naval Air Development Center, Warminster, PA												
N62269-86-D-0124	3	.55	3	.55	3	.55	3	.55	1	.17	1	.17
N62269-87-C-0004	1	.51	1	.51	1	.51	1	.51	1	.51	1	.51
N62269-86-D-0107	4	1.94	4	1.94	4	1.94	4	1.94	4	1.94	4	1.94
Naval Regional Contracting Office, Long Beach, CA												
N00123-85-D-0070	2	.10	2	.10	2	.10	2	.10	2	.10	2	.10
N00123-86-D-0295	5	4.40	5	4.40	5	4.40	5	4.40	5	4.40	5	4.40
U.S. Marine Corps												
M00027-87-D-0029	2	2.39	2	2.39	0	0	2	2.39	0	0	2	2.39
M00027-82-D-0018	3	.48	3	.48	3	.48	3	.48	3	.48	3	.48
Total	69	$23.93	67	$23.43	66	$21.26	62	$21.70	56	$18.68	57	$19.15

FOOTNOTES ARE ON PAGE 1 OF APPENDIX M.

SUMMARY OF SURVEILLANCE OF TIME-AND-MATERIALS CONTRACTS (Continued)

AIR FORCE

Contract Number By Activity	Orders Reviewed 1/		Inadequate Surveillance Plan 2/		Inadequate Site Visits 3/		Inadequate Invoice Review 4/		Inadequate Progress Reports 5/		Inadequate COR/COTR Feedback 6/	
	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)	Quantity	Value (Millions)
San Antonio-Air Logistics Center, Kelly AFB, TX												
F41608-86-D-0010	1	$ 3.50	1	$ 3.50	1	$ 3.50	1	$ 3.50	1	$ 3.50	1	$ 3.50
F41608-87-D-0216	1	2.09	1	2.09	1	2.09	1	2.09	1	2.09	1	2.09
F41608-87-D-0203	1	.04	1	.04	1	.04	1	.04	1	.04	1	.04
F41608-81-G-0046	2	64.61	2	64.61	2	64.61	2	64.61	2	64.61	2	64.61
Sacramento-Air Logistics Center, McClellan AFB, CA												
F04606-84-D-0048	5	3.47	0	0	5	3.47	5	3.47	5	3.47	5	3.47
F04606-86-D-0040	4	.84	4	.84	4	.84	4	.84	4	.84	4	.84
F04606-86-C-0056	1	2.20	1	2.20	1	2.20	1	2.20	1	2.20	1	2.20
F04606-87-C-0137	1	4.24	1	4.24	1	4.24	1	4.24	1	4.24	1	4.24
F04606-87-D-0044	2	1.12	2	1.12	2	1.12	2	1.12	0	0	2	1.12
F04606-84-D-0007	5	5.33	5	5.33	5	5.33	5	5.33	5	5.33	5	5.33
Warner Robins-Air Logistics Center, Robins AFB, GA												
F09603-85-G-0867	4	4.30	4	4.30	4	4.30	4	4.30	4	4.30	4	4.30
F09603-85-G-0681	3	6.93	3	6.93	3	6.93	0	0	3	6.93	3	6.93
F09603-86-G-0954	3	3.24	3	3.24	3	3.24	3	3.24	3	3.24	3	3.24
F09603-85-G-1306	2	3.15	2	3.15	2	3.15	2	3.15	2	3.15	2	3.15
F09603-86-G-0455	5	2.70	5	2.70	5	2.70	5	2.70	5	2.70	5	2.70
F09603-87-G-0424	1	1.44	1	1.44	1	1.44	1	1.44	1	1.44	1	1.44
F09603-84-G-3254	2	9.62	2	9.62	2	9.62	2	9.62	2	9.62	2	9.62
F09650-85-G-0001	1	.12									1	.12
Aeronautical Systems Division, Wright Patterson AFB, OH												
F33657-85-D-2192	2	.56	2	.56	1	.15	1	.15	0	0	2	.56
F33657-85-D-2191	3	.66	3	.66	3	.66	3	66	2	.53	3	.66
2750 Air Base Wing, Wright Patterson AFB, OH												
F33600-84-D-0280	1	2.67	1	2.67	0	0	0	0	0	0	1	2.67
F33600-87-D-0337	2	9.92	2	9.92	0	0	0	0	0	0	2	9.92
Total	52	$132.75	46	$129.16	47	$119.63	44	$112.70	43	$118.23	52	$132.75

FOOTNOTES ARE ON PAGE 1 OF 4 APPENDIX M

PROPOSED CHANGES TO DEFENSE FEDERAL ACQUISITION REGULATION SUPPLEMENT PARTS 201, 202, AND 252

201.6, "Contracting Authority and Responsibilities"

201.604-1, "Designation"

The selection, appointment, and termination of contracting officer representatives (COR's) and contracting officer technical representatives (COTR's), as defined in DFARS 202.101, shall be made by the contracting officer. Such appointments shall take into consider the ability, training, and experience of COR/COTR designees and shall ensure that designees are appropriately trained and qualified to act as authorized representatives of the contracting officer. The COR/COTR designations shall be in writing and shall clearly define the scope and limitations of the authorized representative's authority. Appointment shall be made by letter, as set forth in DoDD 0000.00. COR/COTR designations shall not be redelegable. Unless the appointment of a COR/COTR contains other provisions for automatic termination, the appointment shall be effective, unless sooner revoked, until the COR/COTR appointment may be affected at any time by the appointing authority, or higher authority, or any successor to either.

201.604-2, "Authority and Limitations"

COR's/COTR's are responsible to the contracting officer for those actions delegated by the contracting officer in the letter of appointment. Limitations of COR/COTR authority, as described in DoDD 0000.00, shall also be described in the letter of appointment.

201.604-3, "Documentation"

The contracting officer shall maintain an activity file on each COR/COTR as part of the contract file. The purpose of this file is to record and maintain the results of reviews conducted annually by the contracting officer of the COR's/COTR's contract related activities. The contents of the activity file shall include, but limited to:

(a) a copy of the COR's/COTR's letter of appointment,

(b) examples of in-depth reviews of the COR's/COTR's performance with appropriate identification of the work performed, and

(c) documentation by the contracting officer of the date, substance, and extent of the reviews conducted.

201.604-4, "Contract Clause"

The contracting officer shall insert the clause at 252.000--00, "Contracting Officer's Representative or Contracting Officer's Technical Representative," in solicitations and contracts when appointment of a COR or COTR is anticipated.

202.1, "DEFINITIONS"

"Contracting officers' representative (COR) or contracting officers' technical representative (COTR)" is a technically qualified, properly trained Government employee, appointed in writing by the contracting officer to serve as liaison between the Government and a contractor for the technical aspects of a contract. The COR or COTR monitors contract performance and fulfills other limited duties, as described in the letter of appointment.

252.2, "TEXTS OR PROVISIONS AND CLAUSES 252.000--00 CONTRACTING OFFICER'S REPRESENTATIVE (COR) OR CONTRACTING OFFICER'S TECHNICAL REPRESENTATIVE (COTR) (0000 DATE)"

Name: _____

Mailing Address: _____
_____
_____

Telephone: _____

The COR/COTR will act as the contracting officer's representative for technical matters, providing technical information as necessary with respect to the specifications or statement of work and will monitor the progress of contract performance. The COR/COTR is not the administrative contracting officer and does not have the authority to take any action, either directly or indirectly, that will change the pricing, quantity, quality, delivery schedule, or any other term and condition of the contract, or to direct the accomplishment of effort that goes beyond the scope of the contract statement of work.

If, in the contractor's opinion, the COR/COTR requests or indicates an expectation of effort which would require an equitable adjustment to the contract, the contractor shall promptly notify the contracting officer in writing, but take no other action on that request or effort until the contracting officer has issued a change or otherwise resolved the issue.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefits	Amount and/or Type of Benefit
Finding A		
1.a., 1.b., 1.c., 1.d.	Economy and Efficiency. Reduce the number of improperly awarded time-and-materials contracts.	Undeterminable
2.a., 2.b., 2.c.	Economy and Efficiency. Correct deficiencies that contribute to poor or improper procurement practices.	Nonmonetary
2.d.	Internal Control. Improve procedures related to poor or improper procurement practices.	Nonmonetary
3.	Economy and Efficiency. Reduce the number of improperly awarded time-and-materials contracts.	Undeterminable
Finding B		
1.a., 1.b., 2., 3.	Economy and Efficiency. Implementation of these recommendations will improve withholding provision on time-and-materials contracts. Cost-avoidance will be derived by reducing the amount of money the U.S. Treasury prematurely has to borrow.	Funds put to better use totaling $69.5 million would be realized to appropriation 20x6822(57) Suspense, Public Debt, Government Account Series Interest over a 6-year period commencing in FY 1990 (Appendix K).

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT
(Continued)

Recommendation Reference	Amount and/or Description of Benefits	Type of Benefit
Finding C		
1.a., 1.b.	Internal Control. Improve procedures related to poor or inappropriate contract administration and surveillance practices.	Nonmonetary
2.a., 2.b., 4.	Internal Control. Correct deficiencies that contribute to poor or inappropriate contract administration and surveillance practices.	Nonmonetary
3.a., 3.b.	Internal Control. Correct deficiencies that contribute to poor or inappropriate contract administration and surveillance practices.	Nonmonetary
5.	Compliance with internal control regulations.	Nonmonetary

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Washington, DC
Comptroller of the Department of Defense, Washington, DC
Deputy Assistant Secretary of Defense (Procurement), Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management), Washington, DC
Assistant Secretary of the Army (Research, Development and Acquisition), Washington, DC
Commander, U.S. Army Materiel Command, Alexandria, VA
Commander, U.S. Army Communications and Electronics Command, Fort Monmouth, NJ
Commander, U.S. Army Tank-Automotive Command, Warren, MI
Commander, U.S. Army Armament, Munitions and Chemical Command, Dover, NJ
Commander, U.S. Army Training Support Center, Hampton, VA
Commander, U.S. Army Troop Support Command, St. Louis, MO
Director, U.S. Army Audit Agency Northeast Region, Philadelphia, PA

Department of the Navy

Assistant Secretary of the Navy (Financial Management), Washington, DC
Assistant Secretary of the Navy (Research, Development, and Acquisition), Washington, DC
Headquarters, U.S. Marine Corps, Washington, DC
Commander, Naval Sea Systems Command, Washington, DC
Commander, Naval Air Systems Command, Washington, DC
Commander, Naval Supply Center Command, Washington, DC
Commander, Naval Supply Center, Norfolk, VA
Commander, Naval Supply Center, Charleston, SC
Commander, Naval Air Development Center, Warminster, PA
Commander, Naval Aviation Depot, Cherry Point, NC
Commander, Naval Regional Contracting Center, Long Beach, CA
Commander, Naval Facilities Engineering Command Contract Office, Port Hueneme, CA
Commander, Naval Civil Engineering Laboratory, Port Hueneme, CA
Commander, Naval Air Station, Port Mugu, CA
Commander, Naval Air Station, Patuxent River, MD

ACTIVITIES VISITED OR CONTACTED (Continued)

Department of the Air Force

Assistant Secretary of the Air Force (Acquisition), Washington, DC
Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Air Force Systems Command, Andrews Air Force Base, Washington, DC
Air Force Logistics Command, Wright-Patterson Air Force Base, Dayton, OH
Warner Robins Air Logistics Center, Warner Robins Air Force Base, Robins, GA
San Antonio Air Logistics Center, Kelly Air Force Base, San Antonio, TX
Sacramento Air Logistics Center, McClellan Air Force Base, Sacramento, CA
Oklahoma City Air Logistics Center, Tinker Air Force Base, Oklahoma City, OK
Air Force Contract Management Division, Kirtland Air Force Base, Albuquerque, NM

Defense Agencies

Headquarters, Defense Contract Audit Agency, Alexandria, VA
- Lockheed Georgia Resident Office, Atlanta, GA
- Martin Marietta Resident Office, Orlando, FL
- Hampton Roads Branch Office, Hampton Roads, VA
- Great Lakes Branch Office, Chicago, IL
- McDonnell Aircraft Resident Office, St. Louis, MO
- ESI Suboffice, Dallas, TX
- General Dynamics Ft. Worth Resident Office, Ft. Worth, TX
- Santa Barbara Branch Office, Santa Barbara, CA
- Oxnard Branch Office, Los Angeles, CA
- Rockwell International Corporation Resident Office
  - North County Branch Office, Los Angeles, CA
- Nassau Branch Office, Long Island, NY

Headquarters, Defense Logistics Agency, Alexandria, VA
- Defense Contract Administration Services Region,
  - Philadelphia, PA
  - Los Angeles, CA
  - New York, NY
  - Boston,MA
  - Atlanta, GA
  - Dallas, TX
  - St. Louis, Mo
  - Chicago, IL
  - Columbus, OH

ACTIVITIES VISITED OR CONTACTED (Continued)

Defense Agencies (continued)

Defense Contract Administration Services Management Area
Baltimore, MD
Birmingham, AL
Van Nuys/Goleta Field Office, Santa Barbara, CA
Defense Contract Administration Services Residency Office-Raytheon Company, Goleta, CA
Defense Contract Administration Services Plant Representative Office-General Dynamics, San Diego, CA

Contractors

National System Management Corporation, Arlington, VA
BDM Corporation, Vienna, VA

Other Agencies

U.S. Department of Treasury, Washington, DC
U.S. Department of Labor, Washington, DC

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND LOGISTICS

August 24, 1990

P/CPA

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Report on the Audit of the Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

This is in response to your request for comments on the subject audit. We are attaching for your consideration specific comments on those recommendations pertaining to the Under Secretary of Defense for Acquisition.

David J. Berteau
Principal Deputy

Attachment

Recommendations and ASD(P&L) Comments

Final Report

A. Use of Time-and-Materials Contracts

1. We recommend that the Deputy Assistant Secretary of Defense (Procurement) issue a policy memorandum to the Services to limit the use of time-and-materials contracts by advising all DoD buying commands to: Revised

a. Expand the use of Basic Ordering Agreements with alternative pricing mechanisms.

ASD(P&L) position: Partially concur. The FAR permits time-and-materials contracts when there are requirements for which a time-and-materials contract type may be best suited. FAR 16.601 states that a "time-and-materials contract may be used only when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence." When circumstances warrant their use, time-and-materials type contracts are legitimate vehicles to meet the needs of the government. Accordingly, we do not concur in a need for a memorandum to limit the use of time-and-materials contracts and to encourage the use of Basic Ordering Agreements. The regulation already provides a limitation in that the contracting officer must execute a determination and findings that no other contract type is suitable before entering into a time-and-materials contract. The DASD(P) issued a guidance memorandum (attached) highlighting the existing policy on the proper use and administration of time-and-materials contracts.

b. Use Master Agreements for procuring future technical/engineering services currently procured under time-and-materials contracts as defined by DoD Directive 4205.2 and such services can be procured through Master Agreements under U.S.C., title 10, section 2304, paragraph J.

ASD(P&L) position: Concur. The Department of Defense requested authority to use master agreements to facilitate the acquisition of needed study, advisory, and assistance services on a timely basis. Section 2304 of Title 10 U.S.C. authorizes the award of master agreements under which orders may be issued for the performance of specific advisory and assistance services under a three year program. These master agreements may only be established for those types of advisory and assistance services described in FAR 37.203. The DFARS coverage will be issued and

effective with the issuance of the next quarterly Defense Acquisition Circular, that is, in October 1990.

c. Review contract statements of work when obtaining repair and maintenance support efforts on follow-on contracts to assess the potential for awarding firm-fixed-price contracts. Revised

ASD(P&L) position: Concur. FAR 16.103(c) indicates that "contracting officers should avoid protracted use of a cost-reimbursement or time-and-materials contract after experience provides a basis for firmer pricing." As such, the DASD(P) memorandum reminds contracting officers of their responsibilities in this area.

B. Payments on Time-and-Materials Contracts

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

a. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require contractors to invoice 95 percent of direct labor charges, when a withholding requirement is specified in time-and-materials contracts. Deleted

ASD(P&L) position: Nonconcur. Under the existing Payments under Time and Materials and Labor Hour Contracts Clause, FAR 52.232-7, the Government already has a legal right to withhold money from direct labor charges, up to $50,000. The Government official responsible for reviewing contractor public vouchers on time and material contracts is the Defense Contract Audit Agency auditor. This person is responsible for communicating to the contractor the details of how to prepare a public voucher for any particular contract, and for subsequent review and approval of the contractor's submissions.

Whether the contractor prepares the voucher with the computation of the withheld amount already included, or whether the auditor makes his own computation is a matter of the day-to-day working arrangements at the operational level. It is not appropriate or desirable to burden the Defense Federal Acquisition Regulation Supplement with this level of detail. Nor is it proper to add words to a contract as an attempted substitute for the Government's agents performing their required duties.

b. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require that the $50,000 ceiling Revised and Renumbered B.1.a. due to a deleted Recommendatic

on withholdings be applied to each order, in circumstances involving Basic Ordering Agreements or indefinite delivery contracts using time-and-materials pricing arrangements.

ASD(P&L) position: Partially concur. The recommendation fails to reflect the legal relationship between withholdings and contractor releases. Existing regulations already specify the applicability of the withholdings. The existing contract clause provides for withholding of 5 percent of direct labor, up to a maximum of $50,000, per contract, pending receipt of the contractor's contract release. Under Basic Ordering Agreements, each order is a legally separate contract, and thus requires a separate release and consequently separate withholding. For indefinite delivery contracts, if orders are closed separately, then separate releases are required, and again separate withholdings. If the terms of the particular indefinite delivery contract do not provide for final payment and release by separate order, then withholding by order is not appropriate. The IG recommendation if implemented would break the existing nexus between withholdings and releases. However, in the memorandum discussed in 3. a. below, we will include a restatement of the applicability of the withholding requirement.

c. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require contracting officers to prepare a written justification when the percentage of withholding or application of the $50,000 ceiling is waived or limited.

Renumbered B.1.b. due to a delete Recommendat:

ASD(P&L) position: Nonconcur. The decision on whether to waive the requirement for a five percent withholding is one of a large number of contracting officer decisions that are made every day. For all except the most important decisions, documentation requirements are not specified in the FAR or DFARS, and are instead a matter of common sense and management judgment. We expect our contracting officers and their supervisors to exercise professional judgment in determining which decisions should be documented. It is not appropriate to try to specify this level of detail in the FAR or DFARS. We cannot substitute regulatory requirements for common sense and good judgment.

3. We recommend that the Deputy Assistant Secretary of Defense for Procurement issue a memorandum to all DoD Components, pending implementation of the Defense Federal Acquisition Regulation Supplement changes in Recommendation 1.a., that:

a. Clarifies which personnel are responsible for enforcing contract withholding provisions and for ensuring that the full

Deleted

amount of the required withholding is made on time-and-materials contracts.

ASD(P&L) position: Partially concur. We believe that a memorandum, restating existing policy in more detail, is appropriate. However, we do not concur that changes to the DFARS are required, and therefore do not wholly concur in the recommendation.

b. Requires contracting officers to submit a written justification when the withholding provision is modified to waive or limit the percentage of withholding or application of the $50,000 ceiling. Deleted

ASD(P&L) position: Nonconcur. See discussion of Recommendation B.1.c. above.

4. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over payments made on time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved. Renumbered

ASD(P&L) position: Nonconcur. We believe the policy memorandum described in B.1.b. and B.3.a. will remedy the weaknesses identified.

C. Surveillance of Time-and-Materials Contracts.

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

a. Revise the Defense Federal Acquisition Regulation Supplement, section 216.601 (c)(3), to require that a time-and-materials contract be used only if the contract includes a contract surveillance plan that delineates the responsibilities of the contracting officer, the contract administration office, the Defense Contract Audit Agency, the contracting officer's representative or contracting officer's technical representative, and any other Government officials necessary for efficient and effective contract surveillance. Revised

ASD(P&L) position: Partially concur. The proposed FAR change discussed below should alleviate this concern. The roles and responsibilities of the involved parties are already delineated in the regulation, with the exception of the contracting officer's

representative. This coverage will be in place for all types of contracts, including time and material contracts. The DASD(P) memorandum highlights the need for government surveillance requirements as described in FAR 16.601(b)(1).

b. Revise the Defense Federal Acquisition Regulation Supplement, subparts 201, 202, and 252, to address the appointment, authority, and responsibilities of contracting officer representatives, contracting officer technical representatives, and other technical personnel used to monitor contract performance.

ASD(P&L) position: Concur. On February 27, 1990, the DAR Council approved a proposed rule to revise FAR Parts 1, 2, 42, and 52 as a result of recommendations made by the DMR Regulatory Relief Task Force. The DAR Council forwarded DAR Case 90-473 to the Civilian Agency Acquisition Council for its agreement. The CAAC declined to include the coverage in the FAR. As a result, the DAR Council is preparing DFARS coverage. This coverage should be effective early next fiscal year.

4. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over the surveillance of time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved.

Renumbered C.5. due to an added recommendati

ASD(P&L) position: Nonconcur. The actions taken will remedy the weaknesses identified.

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND
LOGISTICS

AUG 10 1990

P/CPA

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Time-and-Materials Contracts

A recent audit by the Department of Defense Inspector General (Project No. 8CE-0037) contained a finding that time-and-materials contracts are being used inappropriately. You are therefore requested to remind your contracting officers that time-and-materials contracts should only be used when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence (FAR 16.601). In addition, appropriate surveillance of contractor performance is required to give reasonable assurance that efficient methods and effective cost controls are being used.

The audit also addressed the need to review statements of work to assess the potential for awarding firm fixed-price contracts, especially for follow-on effort. Please remind your contracting officers to avoid protracted use of a cost-reimbursement or time-and-materials contract after experience provides a basis for firmer pricing (FAR 16.103(c)).

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary
of Defense (Procurement)

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

JUL 26 1990

(Management Systems)

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Report on the Audit of the Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

Your memorandum dated May 21, 1990, subject as above, requested comments on a recommendation for Comptroller action included in the subject draft report. The recommendation (B 2, page 37) is as follows: "We recommend that the Comptroller of the Department of Defense revise DoD Directive 5105.36, paragraph (D)(4), to require that the Defense Contract Audit Agency's voucher approval process include an examination of the contract provision pertaining to the 5-percent withholding requirement. Where withholding is required, Defense Contract Audit Agency should ensure that voucher or invoice amounts approved for payment under time-and-materials contracts are limited to include only 95 percent of the direct labor charges claimed." 26 Revise

While the Comptroller can understand the IG's concern when a review indicates that proper Government actions are not being taken, we nonconcur with the recommendation to include this level of detail in Department of Defense Directive 5105.36. DCAA has responded directly to your office on this issue (see copy attached) citing coverage included in the DCAA Contract Audit Manual. The attachment to DCAA's memorandum also advises that a memorandum will be sent to the field offices reminding them of their responsibility to review time-and-material contract reimbursable vouchers for compliance with the contractual terms including the 5 percent withholding.

If you have any questions related to this issue, please contact Mr. Harry Hindman (X36502) of my staff.

Alvin Tucker
Deputy Comptroller
(Management Systems)

Attachment

DEFENSE CONTRACT AUDIT AGENCY
CAMERON STATION
ALEXANDRIA, VA 22304-6178

IN REPLY REFER TO

24 JUL 1990

PLD 703.3.3.10 (8CE-0037)

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, AUDITING

SUBJECT: Audit of the Justification for Use of Time-and-Material Contract (Project No. 8CE-0037)

Reference your 21 May 1990 draft report on the subject review. We have reviewed the report and its recommendations, specifically recommendation B.2., and are providing detailed comments.

Please direct any questions regarding this matter to William I. Luke, Chief, Policy Liaison Division, telephone (202) 274-7521.

William J. Shackey
Assistant Director
Policy and Plans

Attachment
AIG(A) Recommendation and DCAA Response

Recommendation B.2.: We recommend that the Comptroller of the Department of Defense revise DoD Directive 5105.36, paragraph (D)(4), to require that the Defense Contract Audit Agency's voucher approval process include an examination of the contract provision pertaining to the 5-percent withholding requirement. Where withholding is required, Defense Contract Audit Agency should ensure that voucher or invoice amounts approved for payment under time-and-material contracts are limited to include only 95 percent of the direct labor charges claimed. Revised

DCAA Response: Nonconcur.

We oppose the recommendation to change DoD Directive 5105.35, paragraph (D)(4), to require that the Defense Contract Audit Agency's voucher approval process include an examination of the contract provision pertaining to the 5-percent withholding requirement. To revise the Agency's "Charter" to resolve a problem such as this seems totally out of proportion to its importance. The examination of interim reimbursement vouchers by DCAA for compliance with contract provisions is adequately covered in the Contract Audit Manual (CAM), paragraphs 6-1003g, 6-1004c, and 6-1007c(4) as follows:

6-1003g: "The primary purpose of the examination and approval of interim public vouchers is to provide reasonable assurance that the amounts claimed are not in excess of that which is properly due the contractor in accordance with the terms of the contract."

6-1004c: "Contractors' interim reimbursement claims will be forwarded for payment to the disbursing officer after appropriate review and approval by the auditor to insure that such payments are consistent with the terms of the contract."

6-1007c: The review will be limited to the following steps:

(4) "Determination that the voucher has generally been properly prepared and that payment for the items listed on the voucher is not precluded by any contractual provisions."

Based on the findings of the IG's audit, we intend to issue a Memorandum to the field reminding them of the responsibility to review time-and-material contract reimbursable vouchers for compliance with the contractual terms, including the 5-percent withholding.

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S. ARMY CONTRACTING SUPPORT AGENCY
5109 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041-3201

REPLY TO
ATTENTION OF

SFRD-KP

18 JUL 1990

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE, 400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Draft Report on the Audit of the Justification for Use of Time-and-Material Contracts (Project No. 8CE-0037)

1. We have reviewed subject report and concur, in general, with findings. However, it is premature to assume that systemic problems or internal control weaknesses exist within the Army pertaining to use of time-and-material/task order type contracts. Specific comments, keyed to recommendations directed at the Army, are set forth below.

a. Recommendations A.2.a, b, and c:

(1) The draft report does not provide specific documentation to substantiate the existence of underlying systemic problems which these recommendations would reduce or eliminate. Consequently, we can neither concur nor nonconcur at this time.

(2) We are taking action to determine whether systemic problems exist within our major buying commands. If so, we will consider the efficacy of recommendations A.2.a, b, and c to address the problem.

b. Recommendation A.2.d: Concur in principle. AFARS currently requires that the Chief of the Contracting Office review and approve determination and findings for use of time-and-materials contracts. However, we will include review of determination and findings for this type contract in our Procurement Management Review Program. We will also request the Department of the Army Inspector General to include this as a review item during command procurement inspections. The estimated completion date for this action is 30 September 1990.

c. Recommendation C.2.a: Nonconcur. AFARS 42.9004 requires that contracting officers distribute copies of Contracting Officer Representative (COR) designations to each administrative contracting officer concerned as well as any other government official having a need therefor. Nevertheless, we will issue a reminder to our contracting activities to ensure that this notification is being made.

SFRD-KP
SUBJECT: Draft Report on the Audit of the Justification for Use of Time-and-Material Contracts (Project No. 8CE-0037)

d. Recommendation C.2.b: Concur. We will amend AFARS Subpart 42.9 to require periodic inspection of COR files to ensure that assigned tasks are being performed. The estimated date for completion of this action is 31 October 1990.

2. The point of contact for this action is Thomas W. Colangelo, SFRD-KP, who may be reached at (703) 756-7564.

NICHOLAS R. HURST
Brigadier General, GS
Director, U.S. Army Contracting
Support Agency

CF:
SAIG-PA
SARD-ZE

THE ASSISTANT SECRETARY OF THE NAVY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

05 SEP 1990

MEMORANDUM FOR DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DRAFT REPORT ON THE AUDIT OF THE JUSTIFICATION FOR USE OF TIME-AND-MATERIALS CONTRACTS (PROJECT NO. 8CE-0037)

Ref: (a) DoD IG (CM) Memo of 21 May 1990

Encl: (1) Department of the Navy Comments on Proposed Recommendations

Enclosure (1) provides the Navy's comments on the recommendations of reference (a).

The Navy shares the DoD IG's concerns with the use of proper contract types. However, we do not feel the objectives of the audit were met. In the discussion of contract types in Section A, the report confuses "time and materials" and "task order contracting", and focuses on downplaying some important benefits of the latter. The report fails to distinguish between task order contracts using fixed (time and material) and cost reimbursable rates. There are benefits and disadvantages to both forms, and occasions where the use of one would be preferable to the other.

The proposed recommendations do not adequately address the problems discussed in the report. In many cases the recommended policies already exist, and the recommended training is already being provided. We agree that adequate surveillance is important, and would support efforts to improve service contract surveillance.

The Navy does not agree with the potential monetary benefits discussed in the report. The sample size was limited, the review did not differentiate between proper and improper waivers, and the calculations did not consider limits imposed by the $50,000 contract cap, or other FAR clauses. Further, Section B discusses the contracting officers' failure to withhold final release retentions, but does not indicate if final releases were obtained.

Finally, the alleged perception that the Navy prefers time and material contracts is not appropriate. The Navy position on contract types is that contained in the FAR and DFARS, with time and material contracts being one of the least preferred types.

Gerald A. Cann

DEPARTMENT OF THE NAVY
COMMENTS ON PROPOSED RECOMMENDATIONS

Section A - Use of Time-and-Materials Contracts

1. We recommend that the Deputy Assistant Secretary of Defense (Procurement) issue a policy memorandum to the Services to limit the use of time-and-materials contracts by advising all DOD buying commands to:

a. Expand the use of Basic Ordering Agreements with alternative pricing mechanisms.

Navy Comment: No comment.

b. Use Master Agreements for procuring future technical/ engineering services currently procured under time-and-materials contracts as defined by DOD Directive 4205.2 and such services can be procured through Master Agreements under U.S.C., title 10, section 2304, paragraph J.

Navy Comment: No comment.

c. Review contract statements of work when obtaining repair and maintenance support efforts on follow-on contracts to assess the potential for awarding firm-fixed-price contracts.

Navy Comment: Nonconcur. FAR 16.104 addresses factors to be considered when selecting contract types.

2. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying commands to:

a. Establish minimum training requirements for technical personnel responsible for preparing statements of work and assessing historical cost and performance data for support service contracts.

Navy Comment: Concur. However, selection of contract type is a responsibility of the contracting officer, not the technical personnel responsible for preparing the statement of work.

b. Increase the level of training for contracting officers lacking experience in awarding various contract types for support services contracts.

Navy Comment: Nonconcur. Existing DoD procurement courses provide instruction on the proper selection of contract types.

c. Assess whether historical cost and performance data from previous contracts can be used to estimate the extent of work and cost of proposed acquisitions.

Navy Comment: Concur. Review should be the responsibility of the requiring activity/contracting officer's representative.

d. Include reviews of determination and findings documents and justifications for use of time-and-materials contracts in command inspections to ensure that analyses and supporting documentation clearly justify the selection of a time-and-materials contract.

Navy Comment: Concur. The current Defense Procurement Management Review Program Manual does not explicitly provide for a review of the rationale for contract type selection. The Navy agrees that such a review is a proper PMR function.

3. We recommend that the Assistant Secretary of the Navy (Research, Development and Acquisition) issue a policy memorandum to Navy buying commands that clarifies the Navy's policy on the justification, selection, and use of time-and-materials contracts. Revised

Navy Comment: Nonconcur. Navy buying commands know the Navy's policy on justification, selection, and use of time-and-materials contracts is the policy provided in FAR and DFARS.

Section B - Payments on Time-and-Material Contracts | Final Report

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to: | Deleted

a. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require contractors to invoice 95 percent of direct labor charges, when a withholding requirement is specified in time-and-materials contracts.

Navy Comment: No comment. | Revised and Renumbered due to a deleted Recommendation

b. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require that the $50,000 ceiling on withholdings be applied to each order, in circumstances involving Basic Ordering Agreements or Indefinite delivery contracts using time-and-materials pricing arrangements.

Navy Comment: Nonconcur. The Navy's interpretation of FAR 52.232-7, "Payments Under Time and Material and Labor Hour Contracts," is that the $50,000 maximum withholding limitation is not to be applied to each order issued under an indefinite delivery contract. The Navy believes the $50,000 amount to be withheld is for the entire contract based on the term "total amount withheld". The Navy realizes that this interpretation is now in litigation at Defense Logistics Agency, Semcor Inc., ASBCA 35145. Further, the withholding provision in FAR 52.232-7(a)(2) should not be punitive nor was it designed to save the Government money on a temporary basis. Its purpose was to provide the necessary incentive to secure the release of claims and liabilities described in paragraph (f) of the same clause. This release is a one-time item to be "executed and delivered," at the time of, and as a condition to, final payment.

c. Revise the Defense Federal Acquisition Regulation Supplement, section 232.111, to require contracting officers to prepare a written justification when the percentage of withholding or application of the $50,000 ceiling is waived or limited. | Renumbered due to a deleted Recommendation

Navy Comment: No comment.

2. We recommend that the Comptroller of the Department of Defense revise DOD Directive 5105.36, paragraph (D)(4), to require that the Defense Contract Audit Agency's voucher approval process include an examination of the contract provision pertaining to the 5-percent withholding requirement. Where withholding is required, Defense Contract Audit Agency should ensure that voucher or invoice amounts approved for payment under time-and-materials contracts are limited to include only 95 percent of the direct labor charges claimed. | Revised

Navy Comment: No comment.

3. We recommend that the Deputy Assistant Secretary of Defense for Procurement issue a memorandum to all DOD Components, pending implementation of the Defense Federal Acquisition Regulation Supplement changes in Recommendation 1.a., that:

a. Clarifies which personnel are responsible for enforcing contract withholding provisions and for ensuring that the full amount of the required withholding is made on time-and-materials contracts. Delete

Navy Comment: No comment.

b. Requires contracting officers to submit a written justification when the withholding provision is modified to waive or limit the percentage of withholding or application of the $50,000 ceiling. Deleted

Navy Comment: No comment.

4. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over payments made on time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved.

Navy Comment: No comment.

Section C - Surveillance of Time-and-Materials Contracts

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to: Revise

a. Revise the Defense Federal Acquisition Regulation Supplement, section 216.601(c)(3), to require that a time-and-materials contract be used only if the contract includes a contract surveillance plan that delineates the responsibilities of the contracting officer, the contract administration office, the Defense Contract Audit Agency, the contracting officer's representative or contracting officer's technical representative, and any other Government officials necessary for efficient and effective contract surveillance.

Navy Comment: No comment.

b. Revise the Defense Federal Acquisition Regulation Supplement, subparts 201, 202, and 252, to address the appointment, authority, and responsibilities of contracting officer representatives, contracting officer technical representatives, and other technical personnel used to monitor contract performance. Prepared revisions are shown in Appendix L.

Navy Comment: No comment.

2. We recommend that the Assistant Secretary of the Army (Research, Development and Acquisition), the Assistant Secretary of the Navy (Research Development and Acquisition), and the Assistant Secretary of the Air Force (Acquisition) require all buying activities to:

a. Establish procedures to inform administrative contracting officers of contracting officer representatives, contracting officer technical representatives and other technical personnel assigned to perform surveillance of time-and-materials contracts.

Navy Comment: Concur. Navy contracts identify the contracting officer's representatives.

b. Develop procedures for conducting inspections of contracting officer representative, contracting officer technical representatives and other technical personnel files on administration and surveillance functions to ensure that assigned tasks are being performed. Revis

Navy Comment: Nonconcur. The Navy's Contracting Officer's Technical Representative Instruction, SECNAVINST 4205.5 dated 18 April 1988, already assigns this review responsibility to the PCO, delegable to the procuring activity's PMR team.

Final Report

3. We recommend that the Director, Defense Logistics Agency: Revised

a. Develop policies and procedures to prevent payments of time-and-materials contract invoices without a verification that the services were provided or received.

Navy Comment: No comment.

b. Ensure that surveillance plans are used for all time-and-materials contracts assigned to a Defense Contract Administration Office in accordance with Defense Logistics Agency Manual 8105.1, subpart 16.601.

Navy Comment: No comment.

4. We recommend that the Under Secretary of Defense for Acquisition report the breakdown of internal controls over the surveillance of time-and-materials contracts to the Secretary of Defense and track the status of corrective actions taken until the problems noted are resolved. Renumbered due to a added Recommendation

Navy Comment: No comment.

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

03 OCT 1990

MEMORANDUM FOR DISTRIBUTION

Subj: TIME-AND-MATERIALS CONTRACTS

Encl: (1) DASD(P) Memorandum P/CPA of 10 Aug 1990; same subject

Enclosure (1) advises of a finding in a draft DoDIG audit (Project No. 8CE-0037) that time-and-materials contracts are being used inappropriately in a number of cases. Accordingly, in selecting time-and-materials contracts, contracting officers should ensure that their use is within the guidelines and limitations of FAR 16.601, and that the contractor's performance is subject to appropriate Government surveillance. In addition, a protracted use of time-and-materials contracts should be avoided after experience provides a basis for firmer pricing.

Please ensure that this guidance is provided to appropriate contracting personnel within your contracting and contract administration offices.

E. G. CAMMACK
Director
Procurement Policy

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DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

JUL 30 1990

MEMORANDUM FOR ACTING DIRECTOR (CONTRACT MANAGEMENT DIRECTORATE)
INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

SUBJECT: DoD(IG) Draft Audit Report on the Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037) - INFORMATION MEMORANDUM

We reviewed subject document and the following paragraphs present a detailed discussion of our position and the actions we are taking in implementing your recommendations. Note that we are only addressing those recommendations expressly directed to the Air Force. Additionally, find below our comments regarding your estimates for potential monetary benefits.

Use of time-and-materials contracts - Recommendation 2. SAF/AQ shall require all the commands to:

a. Establish minimum training requirements for technical personnel responsible for preparing statements of work and assessing historical cost and performance data for support service contracts.

b. Increase the level of training for contracting officers lacking experience in awarding various contract types for support services contracts.

c. Assess whether historical cost and performance data from previous contracts can be used to estimate the extent of work and cost of follow-on acquisitions.

d. Include reviews of determination and findings documents and justifications for use of time-and-materials contracts in command inspections to ensure that analyses and supporting documentation clearly justify the selection of a time-and-materials contract.

Answer. Concur

a. The Air Force believes that training for technical personnel responsible for preparing statements of work and assessing historical cost and performance data for support services contracts is very important. However, we recognize that our technical people perform these duties from time to time, rather than on a day-to-day basis and, therefore, establishing minimum training requirements may not cure the problem. We

believe that a training policy approach requesting buying commands to properly train technical personnel before writing statements of work or assessing historical cost and performance data is more appropriate. Therefore, we will send a letter to the buying commands emphasizing the need to carefully train technical personnel before they are tasked to write statements of work or to assess historical cost and performance data, and directing them to provide such a training. This action will be completed by October 1990.

b. The training program for contracting officers at buying commands is a continuous process and covers all aspects of contracting including types of contracts authorized by the Federal Acquisition Regulation and the criteria for their use. However, we acknowledge that contracting officers lacking experience on time-and-materials type contracts, and the acquisition of engineering, repair, and maintenance services will need additional training in these areas. Therefore, we will issue a letter to buying commands emphasizing the need to adequately train contracting officers on the various types of contracts suitable for services contracts, and directing them to review training plans and individual personnel training folders to insure that this training is being performed. This action will be completed by October 1990.

c. The Air Force concurs with the auditor's comments that the assessment of historical cost and performance data from previous similar efforts could produce factual information which could be used to estimate the extent of work and the cost of the follow-on acquisition. Knowing these two factors may certainly make other than a time-and-materials type contract more suitable, and the end result would be more control on costs. Therefore, the letter that we plan to send to the field will also stress the importance of historical cost and performance data assessment and the application of the results for defining the follow-on contractual effort and determining the type of contract best suited to the specific effort. This action will be completed by October 1990.

d. The use and proper documentation of time-and-materials type contracts is already one of the priority topics on the Air Force Audit Agency agenda. The Air Force Logistics Command IG is presently conducting a thorough inspection throughout all buying activities in these areas. In addition, the letter that we are sending to the field will direct all Air Force buying activities to include reviews of determinations and findings documents and justifications for use of time-and-materials type contracts in command inspections. We expect that the implementation of our planned corrective actions will successfully remedy identified deficiencies. However, if deficiencies persist, we will re-visit this area at a later date. This action will be completed by October 1990.

Surveillance of time-and-materials contracts - Recommendation 2. SAF/AQ shall require all buying activities to:

a. Establish procedures to inform administrative contracting officers of contracting officer representatives, contracting officer technical representatives and other technical personnel assigned to perform surveillance of time-and-materials contracts.

b. Develop procedures for conducting inspections of contracting officer representative, contracting officer technical representatives and other technical personnel files on administration and surveillance functions to ensure that assigned tasks are being performed.

Answer. Concur

The Air Force believes that close monitoring of time-and-materials contracts in the field, their proper administration, and surveillance is both necessary and important. Furthermore, the Air Force agrees that additional policy is needed in this area. As a result, we are presently rewriting Air Force Regulation (AFR) 400-28 "Service Contracts." This new version will incorporate the present AFRs 70-9 "Base Level Services Contract Administration," 400-28 and 400-29 "Contracting for Major Operational Maintenance Services" and will be applicable to all Air Force services contracts. The new AFR 400-28 establishes procedures and defines responsibilities for contracting officers, contracting officer technical representatives, and other technical personnel involved in the surveillance of services contracts. Additionally, it prescribes policy on delegations and appointments, surveillance plans, and documentation of surveillance performed. Thus, the Air Force regulation, when published, will implement your two recommendations. This action will be completed by January 1990.

In the area of potential monetary savings, we have reviewed your backup documentation and find it insufficient to verify the amounts. Therefore, the Air Force cannot agree nor disagree with the amounts you stated on your draft audit report at this time.

If your staff has any questions concerning our comments, have them call Captain Maria Hernaez, SAF/AQCP, at 697-6522.

IRA L. KEMP
Associate Deputy Assistant
Secretary (Contracting)
Assistant Secretary (Acquisition)

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

OCT 17 1990

MEMORANDUM FOR ACTING DIRECTOR (CONTRACT MANAGEMENT DIRECTORATE)
INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

SUBJECT: DoD(IG) Draft Audit Report on the Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037) - ACTION MEMORANDUM

The Air Force comments on subject audit were submitted to your office on July 30, 1990. However, the Air Force was unable to comment on the potential monetary benefits stated on the draft audit report due to insufficient backup documentation to verify your stated amounts. Since then, you have provided additional data in this area, and have requested the Air Force submit comments on the potential monetary benefits to be included in the draft report you are about to publish.

We understand that the Air Force's portion of the projected five year $55.9 million monetary benefits is approximately $5 million. This figure, based on the assumptions you made, appears reasonable and we have no basis to question it.

If your staff has any questions concerning our comments, have them call Captain Mariaisabel Hernaez, SAF/AQCP, at 697-6522.

IRA L. KEMP
Associate Deputy Assistant
Secretary (Contracting)
Assistant Secretary (Acquisition)

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

01 AUG 1990

IN REPLY REFER TO DLA-CI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on the Audit of the Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

The enclosed comments to the draft report are provided in response to your memorandum dated 21 May 1990. The comments have been approved by Ms. Helen T. McCoy, Deputy Comptroller, Defense Logistics Agency.

3 Encl

Reathea E. Holmes
REATHEA E. HOLMES
Chief, Internal Review Division
Office of Comptroller

TYPE OF REPORT: AUDIT DATE OF POSITION: 31 Jul 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

FINDING C: Surveillance of Time-and-Materials Contracts. DoD contracting officials did not perform effective surveillance of time-and-materials contracts as required by the Federal Acquisition Regulation (FAR). Effective surveillance was not performed primarily because coordination, communication, and oversight did not exist between the individuals responsible for contract administration and surveillance functions. Surveillance plans were not prepared to describe the methods to be employed for coordinating and monitoring contractor performance and contract cost. In addition, the policies and procedures concerning the appointment and authority of technical personnel assigned to contract surveillance functions were not addressed by the Defense Federal Acquisition Regulation Supplement (DFARS). As a result, there was no assurance that the Government received the goods or services it paid for under time-and-materials contracts. Failure to provide adequate surveillance over time-and-materials contracts is contrary to the FAR and constitutes a material internal control weakness reportable to the Secretary of Defense.

DLA COMMENTS: Partially concur. We agree that it is important for the Contract Administration Team to develop a coordinated action and surveillance plan for Time and Materials Contracts (see DLAM 8105.1, Part 16.601). Surveillance plans are prepared on each contract or for groups of contracts of similar characteristics under administration at the same contractor facility and, as a minimum, are required to contain specific methods to be employed for coordinating and monitoring contractor performance and cost. The guidance also encourages the ACO, as team leader, to convene a meeting of all DCMC functional specialists, and those external specialists such as the DCAA Auditors, who will be involved in the surveillance of contract performance. These meetings and the surveillance plans ensure communication between the involved parties and consistent oversight of the surveillance functions. We agree that the policies and procedures concerning the appointment and authority of technical personnel (COR/COTR) assigned to contract surveillance functions are not addressed by the Defense Federal Acquisition Regulation Supplement. It should be pointed out that these technical personnel (COR/COTR) are appointed and controlled by the PCO and are not under the control of the ACO. While it is not always possible or cost effective to perform 100% surveillance on monthly interim vouchers, final acceptance of the goods or services is a contractual requirement and must be obtained prior to contract closeout and final payment is not made unless it has been obtained and the contract audited and financially reconciled. We have adequate policies and procedures in place for surveillance factors within our scope of authority and will remind our activities of their responsibility. We do not agree that there is a material internal control weakness reportable to the Secretary of Defense on our part.

MONETARY BENEFITS: None.
DLA COMMENTS:

ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Mrs. Audet, DLA-AC

DLA APPROVAL: Helen T. McCoy

TYPE OF REPORT: AUDIT DATE OF POSITION: 31 Jul 90

PURPOSE OF INPUT: INITIAL POSITION

Final Report

AUDIT TITLE AND NUMBER: Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

RECOMMENDATION NUMBER C.3.a.: We recommend that the Director, Defense Logistics Agency develop policies and procedures to prevent payments of time-and-materials contract invoices without a verification that the services were provided or received. Revise

DLA COMMENTS: Nonconcur. Various T&M contracts specify different forms of acceptance of supplies or services prior to payments. T&M contracts sometimes require that the COR/COTR sign off on the voucher or attach a certification to the voucher before it is submitted to DCAA for approval and subsequent submission to the payment office. This procedure provides assurance that the material/services were provided before payments are made. Just as with any other cost type contract the contractor is required to substantiate his vouchers with appropriate backup data and an audit trail (e.g., time cards, records of purchases, and other accounting data). Interim vouchers are submitted to DCAA for review and approval and final acceptance of the goods and services are required by every contract. Many T&M contracts require monthly progress reports be submitted to the PCO and the COTR as part of the data required under the contract. Inclusion of this or any other requirement such as milestone is an issue that can only be addressed by the PCOs and by the Military Services who are involved in the award of these contracts. The ACO surveillance plan cannot overcome structural contractual defects that do not provide for the contract to provide the Government with substantiation of progress on the goods or services. The ACO surveillance plan only provides direction for DCMC personnel, not the COTR and DCAA who are regulated by their own sets of agency requirements. Documentation of the performance should be a requirement of the contract, not the surveillance plan.

DISPOSITION:
( ) Action is ongoing; Final Estimated Completion Date.
(x) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Mrs. Audet, DLA-AC

DLA APPROVAL: Helen T. McCoy

TYPE OF REPORT: AUDIT DATE OF POSITION: 31 Jul 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Justification for Use of Time-and-Materials Contracts (Project No. 8CE-0037)

RECOMMENDATION NUMBER C.3.b.: We recommend that the Director, Defense Logistics Agency ensure that surveillance plans are used for all time-and-materials contracts assigned to a Defense Contract Administration Office in accordance with Defense Logistics Agency Manual 8105.1, subpart 16.601.

DLA COMMENTS: Concur. A numbered letter has been sent to our field offices reminding them to follow the guidance in DLAM 8105.1, Part 16.601 relative to the use of surveillance plans on T&M contracts (Attachment).

DISPOSITION:
( ) Action is ongoing; Final Estimate Completion Date:
(X) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur.
( ) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Mrs. Audet, DLA-AC

DLA APPROVAL: Helen T. McCoy

ATTACHMENT

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

27 JUL 1990

IN REPLY REFER TO DLA-AC

SUBJECT: DLA-AC Letter No. AC-90-22
Time and Materials Contracts

TO: Commanders of DCM Regions
ATTN: Directors, Contract Management

This letter is directive in nature and expires when incorporated into DLAM 8105.1 unless sooner superseded or rescinded. This letter should be circulated to Regional personnel in the following organizational code: AC.

1. Recently, we received a draft DoD Inspector General (IG) report which indicated that surveillance over time-and-materials contracts was ineffective. According to the DoD IG report, effective surveillance was not performed because coordination, communication, and oversight did not exist between the individuals responsible for contract administration and the buying commands' technical representatives. In addition, surveillance plans were not prepared to describe the methods to be employed for coordinating and monitoring contractor performance and contract cost. The DoD IG commented that there was no assurance that the Government received the goods or services it paid for under time-and-materials contracts.

2. Defense Logistics Agency Manual 8105.1, Part 16.601, "Time and Materials Contracts," provides guidance for administering such contracts. Specifically, the Administrative Contracting Officer (ACO), as team leader, shall review the requirements of the contract and convene a meeting of the functional specialists, including Defense Contract Audit Agency auditors, when appropriate, to perform surveillance of contract performance. The purpose of that meeting is to develop a coordinated written plan establishing the action and surveillance responsibility of each team member. Furthermore, as a minimum, the plan shall provide for: (a) a determination as to the adequacy of the contractor's accounting system; (b) surveillance of the contractor's plant operations to ensure that the direct labor and direct materials being charged to the contract are allowable, allocable, and reasonable; (c) periodic onsite inspections and floor checks; (d) periodic audits of contractor's billings under the contract; and (e) ensuring full and complete communication with the ACO and other team members on the status of surveillance efforts.

3. Effective development and implementation of time-and-materials contract surveillance plans are important for ensuring proper

control of costs. Consequently, not only should ACOs ensure that such plans are developed and well coordinated among team members but Region staff personnel should monitor overall policy compliance during their staff assistance visits to field activities. If you have any questions concerning this matter, please contact Mr. William Hill at AV 284-7726 or (202) 274-7726.

FOR THE DIRECTOR:

JAMES R MCNABNAY
Captain, SC, USN
Deputy Executive Director
Contract Management

RECOMMENDATIONS REQUIRING ADDITIONAL COMMENTS AND RECOMMENDATIONS THAT WERE REVISED OR ADDED IN THE FINAL REPORT

Recommendations Requiring Additional Comments

Assistant Secretary of Defense (Production and Logistics) - A.1.d., B.1.a., B.1.b., B.3., C.1.a., C.5.

Assistant Secretary of the Army (Research, Development, and Acquisition) - A.2.a., A.2.b., A.2.c.

Assistant Secretary of the Navy (Research, Development and Acquisition) - A.2.a., A.2.b., A.2.c., A.2.d., C.4.

Director, Defense Contract Audit Agency - B.2.

Director, Defense Logistics Agency - C.3.a.

Recommendations in the Draft Report that were Deleted From the Final Report

Recommendations

B.1.a., B.3.a., B.3.b.

Recommendations that were Revised in the Final Report

Recommendations

A.1.a., A.1.c., A.3., B.1.a., B.2., C.1.a., C.2.b., C.3.a.

Recommendations that were Added in the Final Report

Recommendations

A.1.d., C.4.

AUDIT TEAM MEMBERS

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