

Policy and

Oversight



Contract Audit Directorate

DoD Requests for Field Pricing Audit Support

Report Number PO 97-058

September 30, 1997

Office of the Inspector General
Department of Defense

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Acronyms

ACO	Administrative Contracting Officer
AFIT	Air Force Institute of Technology
AMC	Army Materiel Command
AMIS	Agency Management Information System
CAO	Contract Administration Offices
CECOM	U.S. Army Communications Electronics Command
CO	Contracting Officer
DCAA	Defense Contract Audit Agency
DCMC	Defense Contract Management Command
DFARS	Defense Federal Acquisition Regulation Supplement
FAI	Federal Acquisition Institute
FAR	Federal Acquisition Regulation
FAO	Field Audit Office
FPRA	Forward Pricing Rate Agreement
FPRR	Forward Pricing Rate Recommendation
IGE	Independent Government Estimate
MPC	Most Probable Cost
NAPS	Naval Acquisition Policy Supplement
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
PAT	Process Action Team
SUPSHIP	Superintendent of Shipbuilding
USD(A&T)	Under Secretary of Defense for Acquisition and Technology



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September 30, 1997

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
AND TECHNOLOGY**

**SUBJECT: Report on Evaluation of DoD Requests for Field Pricing Audit Support
(Report No. PO 97-058)**

We are providing this evaluation report for review and comment. This is one in a series of two reports. This report addresses contracting officer requests for field pricing support, including audit services. The second report will address Defense Contract Audit Agency procedures for responding to audit requests and the adequacy of audit coverage. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. Therefore, we request that management provide comments on this report by December 1, 1997.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. Maurice Nestor, Program Director, at (703) 604-8789 (DSN 664-8789), or Ms. Madelaine E. Fusfield, Program Manager, at (703) 604-8739 (DSN 664-8739). See Appendix F for the report distribution. The audit or evaluation team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. PO 97-058
(Project No. 6OC-0086)

September 30, 1997

Evaluation of DoD Requests for Field Pricing Audit Support

Executive Summary

Introduction. This is one in a series of two reports, and it addresses contracting officers requests for field pricing support, including audit services. A second report will address Defense Contract Audit Agency procedures for responding to audit requests and the adequacy of audit coverage.

Contracting officers use field pricing support to evaluate contractor price proposals in compliance with the Federal Acquisition Regulation. Contracting officers also use field pricing support when they do not have adequate information available to determine the reasonableness of the offer. Audits performed in compliance with Government Auditing Standards and resulting in detailed reports consume significant audit resources. For FY 1996, auditors received more than 11,000 requests for field pricing support and used more than 580 staff years, exclusive of supervision, to complete the requests. An additional 167 staff years were spent reviewing forward pricing rates associated with contractors' proposals.

Evaluation Objectives. The overall objective of the review was to evaluate the process used to request and complete Defense Contract Audit Agency audits and reviews of contractor price proposals, with emphasis on major weapons programs. The evaluation also assessed the adequacy of management control procedures at field audit offices, DoD contract administration offices, and Military Department procurement offices for determining the scope of requested audit assistance.

Evaluation Results. Our review of pricing actions and applicable requests for field pricing and audit services at seven field audit offices, six contract administration field offices, and four military procurement offices showed that audit requests and the scope of requested services were appropriate for large proposals when cost or pricing data were required. Price analysts at procurement offices adequately determined cost realism for 12 large, competitive procurements before selecting the contractor. However, 54 of the 83 audits requested were unnecessary because sufficient pricing information to evaluate the reasonableness of cost or pricing data in proposals without field pricing reports was already available at the buying command, the cognizant contract administrative office, or the Defense Contract Audit Agency audit office. In addition, 8 of 10 cost realism reviews were unnecessary because information was already available to complete the pricing action. A significant number of requests were not properly tailored to the minimum information required to complete the pricing action. Procurement offices did not have adequate practices and procedures for implementing existing DoD guidance on requesting field pricing reviews of low-risk proposals. The Army, Navy, and Air Force also had different regulations and practices for evaluating the cost realism of competitive procurements. Current practices waste significant audit and field pricing resources that could be put to better use.

A current rewrite of the Federal Acquisition Regulation does not include specific information to instruct contracting officers and price analysts on the type of information they may find useful in limiting requested field pricing services and audits. The rewrite also omits the existing reference to contract auditors as sources of information to determine the necessity and scope of field pricing.

Recommendations in this report, if implemented, will result in standard procurement practices and procedures to improve implementation of DoD guidelines to reduce oversight of low dollar, low risk proposals. The result will be more effective use of audit resources. The related savings from reduced oversight of price proposals will reduce contractor overhead costs incurred when supporting low-risk audits and, therefore, reduce acquisition costs.

Summary of Recommendations. We recommend that the Under Secretary of Defense for Acquisition and Technology amend the *Cost Analysis Desk Reference* incorporated in the Defense Acquisition Deskbook to provide specific guidance to contracting officers for obtaining and utilizing information available at contract administration and audit field offices without requesting detailed audits. The Under Secretary of Defense for Acquisition and Technology should issue guidance to the military procurement and contract administration offices to modify office practices and procedures to conform with the guidance in the Defense Acquisition Deskbook. The Under Secretary should also establish a joint military departmental action team to study and report on reasonable methods for evaluating cost realism for source selection and document agreed-to methods in the *Cost Analysis Desk Reference*.

Management Comments. The Director of Defense Procurement concurred with our recommendations to direct buying organizations to coordinate with field offices before requesting detailed audits and to use simplified procedures to complete field pricing. The Director partially concurred with three recommendations to improve common guidance in the *Contract Pricing Reference Guides* and one recommendation that buying activities modify office practices to conform with the common guidance. However, the Director disagreed that the guidance should be made directive. Because, to require buying activities to comply with non-directional guidance is contrary to the principles of acquisition reform that include empowerment of field personnel.

The Director nonconcurred with two recommendations that contracting officers document reasons for requesting detailed field pricing reports on procurements below the regulatory thresholds and that a process action team be established to report on reasonable methods for evaluating cost realism for source selections. The Director stated that the proposed Federal Acquisition Regulation part 15 rewrite does not include regulatory thresholds. Also, Volume IV of the *Contract Pricing Reference Guides*, Advanced Issues in Contract Pricing, contains sufficient guidance on cost realism analysis.

Evaluation Response. Management comments were generally responsive to our recommendations. We request the opportunity to evaluate the draft updates of the *Contract Pricing Reference Guides*. While issuance of the Federal Acquisition Regulation part 15 rewrite alone cannot achieve the required improvements, we expect that procurement and contract administration organizations will develop local procedures to implement the new guidelines and conduct required training to familiarize staff with the new provisions. Existing, more prescriptive guidance did not result in adequate communication and coordination on audit requests.

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Part I - Evaluation Results

Evaluation Background

Contracting Officers. Contracting officers (COs) can request the advice of price analysts, contract auditors, quality control specialists, and engineers before negotiating final contract awards. When offerors are required to submit certified cost or pricing data under the Truth in Negotiations Act, Title 10, United States Code, Section 2306a, and the proposed amounts exceed certain dollar thresholds, contracting officers usually request field pricing services, including Defense Contract Audit Agency (DCAA) audits. Specifically, negotiated competitive procurements (in contrast to sealed bids) that are awarded based on best value usually result in requests for field pricing support.

Federal Acquisition Regulation (FAR). The FAR 15.805-5, "Field Pricing Support," stipulates that CO requests for field pricing support should be tailored to ask for the minimum information necessary to ensure a fair and reasonable price. When the Government has adequate information to analyze cost or price, an audit to determine the allowability, allocability, and reasonableness of cost or pricing data is unnecessary. The FAR and the Defense Federal Acquisition Regulation Supplement (DFARS) 215.805-5, "Field Pricing Support," exempt from field pricing proposals for fixed-price contracts under \$500,000 and cost reimbursable contracts under \$10 million when contractor estimating systems are adequate and cost and pricing information is already available. The threshold is \$500,000 for cost reimbursable contracts when estimating systems are not adequate. The FAR provides a list of information that can help determine the extent of any audit support that is needed. The information is usually available through the cognizant Administrative Contract Officer (ACO) or auditor.

Competitive Procurements. Competitive procurements differ from non-competitive procurements in that the prices offered in competitive proposals cannot be adjusted and field pricing support is not required. The Government has no basis to question costs, adjust the price, or otherwise lower the contractor's offer. Also, negotiated competitive contracts (in contrast to sealed-bids) are awarded based on the best value, not lowest price, to the Government. Contracting officers use cost realism analysis to determine the most probable cost (MPC), and the MPC is used to calculate a score for the cost factor, one of several factors used to decide the best value.

Cost Realism. Cost realism reviews include analysis of several variables, but field pricing support is usually limited to verifications of contractor direct and indirect rates. The costs in the offeror's proposal should be, realistic for the work to be performed, reflect a clear understanding of the requirements, and be consistent with the various elements of the offeror's technical proposal. Cost realism reviews include a technical evaluation of materials requirements and manpower loading (including labor mix and hours), comparisons of proposed labor and indirect rates to available rate and pricing information, and either price or cost comparisons to Independent Government Estimates (IGEs).

The Defense Contract Audit Agency (DCAA). The DCAA performs various audits and evaluations of contractor price proposals depending on the nature of

the audit request for field pricing support and the amount and reliability of information already available. Field pricing audits include the following:

- o forward pricing rate reviews;
- o contractor estimating system surveys;
- o individual price proposals;
- o single cost elements;
- o cost realism reviews; and
- o telephone confirmations of specific cost information.

Forward pricing rate reviews represent comprehensive audits of contractor annual budgets for labor and indirect rates. These audits may result in written forward-pricing rate agreements or Government-accepted rates that contractors will use for a specified time period to price proposed contracts. The DCAA may also perform agreed-to-procedure reviews, which are limited to verifying that proposed rates agree with current Government-accepted rates and to providing additional information as requested by the contracting officer. Auditors can usually confirm rates through telephone conversations with COs and issue informal telephone confirmation memorandums.

Evaluation Objectives

The overall objective of the review was to evaluate the process used by COs and ACOs to request DCAA reviews of contractor price proposals, with emphasis on major weapons programs. The evaluation also assessed the adequacy of management control procedures at DCAA field offices, DoD contract administration offices, and Military Department procurement commands for determining the scope of requested audit assistance. See Appendix A for the evaluation scope and methodology and Appendix B for other matters of interest.

Unnecessary Requests for Field Pricing Services

The DoD procurement offices responsible for major weapons acquisitions generally requested field pricing and audit support to determine the fairness and reasonableness of proposed prices above the FAR/DFARS threshold for field pricing reviews. However, COs frequently requested unnecessary audits or reviews and detailed field pricing reports on cost or pricing data in noncompetitive proposals below the thresholds. The COs issued the unnecessary requests for field support before contacting contract administration offices (CAOs) or DCAA field audit offices (FAOs) to discuss whether information could be obtained from those offices without formal audit or review procedures. Eight of 10 cost realism reviews were not necessary. The Army, Navy, and Air Force also differed in their use of field pricing assistance on cost realism reviews of competitive procurements. Due to better procurement office practices and procedures, the Air Force issued fewer requests for cost realism reviews than the Army or the Navy. Only the Air Force used IGEs, which appeared to be a better benchmark for evaluating cost realism than methods used by the other Services. Further, a current rewrite of the FAR does not entirely remedy the weak guidelines in the current FAR which contribute to the unnecessary requests for audit services.

Buying command practices for evaluating cost or pricing data in non-competitive proposals or for performing cost realism analyses of competitive bids are contrary to DoD acquisition streamlining objectives to reduce Government oversight, conserve resources, and reduce cycle time for awarding contracts. Current practices waste significant audit and field pricing resources that could be put to better use.

Requesting Audit Support

Audit support is not necessary when field offices have the necessary information readily available. The COs should coordinate with procurement liaison auditors located at the buying command, cognizant DCAA FAOs, and CAOs to identify available information and determine the extent of audit support needed, if any. Information already available may include Forward Pricing Rate Agreements (FPRAs), ACO Forward Pricing Rate Recommendations (FPRRs), or current audit recommended labor and indirect rate forward-pricing reports. The referenced rate information and the results of a technical analysis may provide all the information necessary to evaluate cost reasonableness or cost realism. If a proposal includes only limited costs for materials and travel, FAR 15.805-5(d) also stipulates that the CO, the ACO, or their representative can request and review contractor records supporting any proposed cost elements. Auditors or

ACOs may furnish information on current labor and indirect rates or factors to the CO through telephone confirmation, facsimile, or brief written memorandums.

The COs should request audits and reports only when current information is not available at the cognizant field offices or when proposals are sufficiently complex to increase the risk of cost misrepresentation or errors. However, when audit assistance is required, requests should be tailored to the cost elements for which information is not available.

Audit Requests Reviewed. The COs or their representatives requested unnecessary audits or review procedures for 54 (65 percent) of the 83 contractor proposals evaluated during field visits to 7 DCAA FAOs and 6 CAOs. Thirty-four of the 54 proposals were mostly of low-dollar values and did not include any bills of material. We did not visit the offices that originated the 34 requests for proposal reviews. The remaining 20 unnecessary requests originated with 4 procurement offices, which we visited to follow up on observations at audit offices. The document files reviewed at the four procurement offices confirmed that DoD managers had sufficient information to verify cost elements without the need to perform special audit services because pricing information was already available as a result of recent DCAA audits. Information available included current FRPAs between the Government and contractors on labor and indirect rates, FPRRs, recently audited rates, payroll information, agreed-to labor and materials standards, blanket purchase orders, and on-line access to labor rates, purchase orders, quotes, and purchase history.

The following table summarizes the requests for audits of noncompetitive proposals. Appendix C lists the number and average value of requests by the requesting offices.

	Requests for Audit of Noncompetitive Proposals			
	<u>Total Requests</u>		<u>Average Dollar Value</u>	
	<u>Unnecessary</u>	<u>Necessary</u>	<u>Unnecessary</u>	<u>Necessary</u>
Army	5	5	\$7,500,830	\$61,048,018
Navy	7	10	3,111,658	33,762,395
Air Force	15	4	1,989,399	10,612,366
DCMC ¹	19	8	1,987,018	4,045,038
SUPSHIP ²	6	1	1,597,362	889,000
Other	<u>2</u>	<u>1</u>	1,612,542	1,952,547
Total/Avg. Value	54	29	\$2,640,251	\$24,845,357³

1. Defense Contract Management Command
 2. Superintendent of Shipbuilding
 3. Average weighted value

Communication and Coordination of Requests. The COs, CAOs, and DCAA normally did not coordinate on audit requests. The COs were generally

Unnecessary Requests for Field Pricing Service

not aware of contractor pricing information already available at DoD offices nor did they inquire. Supervisory auditors stated they were usually not contacted before receiving audit requests, particularly for lower dollar proposals.

The DoD managers also disagreed on the extent of information needed to evaluate cost reasonableness and may have had a different understanding than the auditors of the type of services rendered as part of audits, agreed-to-procedures, and rate verifications. One program manager believed audits below the DFARS/FAR thresholds were necessary even when the contractor's estimating system was adequate, FPRAs existed, and the proposed costs were limited to direct labor and indirect rates. The justification for the audit request was that the contracting officer did not know whether the FPRA had changed. However, one of the primary reasons for coordination and communication before requesting an audit is to determine whether key information is current. In another case, a CO issued blanket agreements to audit all proposals above a \$1 million threshold because he believed that was the threshold for requiring audits. Most COs interviewed understood that audits were unnecessary in those circumstances although many price analysts requested audits.

Inconsistent Operating Procedures. None of the offices visited had adequate standard operating procedures to guide price analysts to critically assess the level of audit support necessary before issuing requests. Some Navy offices used boilerplate audit requests to obtain extensive but unnecessary audit services. A Superintendent of Shipbuilding office merely received the contractor's proposals, initialed them, and forwarded them to the audit office. The Defense Contract Management Command (DCMC) buyers and ACOs forwarded comprehensive audit requests from prime contractors to DCAA without determining the risk and availability of pricing information or whether pricing assistance could be streamlined. Contract or pricing specialists in collocated DoD contract administration and audit offices often did not meet to discuss the best method of completing the cost analysis.

The Defense Acquisition Deskbook¹ is a collection of procurement regulations, acquisition laws, guidance and instructional materials developed by the Offices of Acquisition Reform and Acquisition Program Integration within the Office of the Secretary of Defense. The Deskbook is maintained on a compact disk - read only memory (CD-ROM) by the Joint Program Office at Wright Patterson Air Force Base. The Air Force Institute of Technology (AFIT) and the Federal Acquisition Institute (FAI) have developed common guidance for price and cost analysis in the Contract Pricing Reference Guides,² which are included in the Deskbook. The Reference Guides encompass five volumes: Price Analysis, Cost Analysis, Quantitative Techniques for Contract Pricing, Advanced Issues in Contract Pricing, and Federal Contract Negotiation Techniques. The reference guides provide non-directional guidance, instruction, discussion, and examples on applying pricing policies. Guidance on requesting field pricing is provided in the Cost Analysis reference guide. However, the guidance does not include adequate information on simplified procedures for field pricing and does not inform users of information that may be available without an audit from

¹*The Defense Acquisition Deskbook*, version 1.4, Joint Program Office, Wright-Patterson Air Force Base, Ohio, March 31, 1997.

² *Contract Pricing Reference Guides*, Air Force Institute of Technology, Wright-Patterson Air Force Base, Ohio, March 31, 1997.

contract administration or audit field offices. Examples of information that may be available without an audit include recent production costs, established pricing formulas, standard component prices, and current audited and agreed-to rates for labor, indirect costs, and other costs. Field offices can confirm cost and rate information through telephone or facsimile transmittals. The DCAA Contract Audit Manual guides auditors to issue a brief memorandum confirmation of proposed specific cost information when that information is readily available without special audit procedures. To ensure that requests for field pricing support are appropriately tailored to avoid unnecessary audit procedures, the Deskbook should include guidance on the availability and usefulness of less detailed field pricing procedures to be used when a procurement presents low risk that costs are misrepresented.

Acquisition Guidelines

The current FAR 15.805-5(a)(1)(A) guidance provides a list of information that can be useful in determining the extent of audit support required. The current guidance implies, but does not require, that contracting officers contact cognizant field offices before requesting audits. However, we observed that offices failed to comply with existing FAR provisions, and many Cos did not coordinate with field offices to inquire about information that may be available without formal audit procedures and reports.

Proposed FAR Revisions. Changes to regulations for requesting field pricing have been proposed in FAR Case No. 95-029, Part 15 Rewrite: Contracting by Negotiation; Competitive Range Determinations, published in the Federal Register, May 14, 1997. Proposed revisions require COs to request field pricing assistance when the information available at the buying organization is inadequate to determine a fair and reasonable price. However, the revisions do not include specific guidance to instruct Cos and price analysts on the type of information they may find useful to limit requested field pricing services and audits. The revisions also omit the existing reference to contract auditors as sources of information to determine the necessity and scope of field pricing. If the FAR identified such information, COs may be inclined to coordinate with field offices to obtain and use it instead of requesting field services. The proposed FAR changes require that requests be tailored to reflect the minimum essential supplementary information, but the changes eliminate the FAR list of pricing information usually available from cognizant audit offices and thereby any reference to suggest COs contact cognizant auditors. The proposed rule also removes the FAR 15.805-5(b)/DFARS 15.805-5(a)(1)(A) threshold restrictions on field pricing requests for low-risk/low-dollar proposals. We provided our comments on the FAR part 15 rewrite to the FAR Secretariat on July 14, 1997.

The proposal to abolish the thresholds is contrary to Recommendation 5. of the DoD Process Action Team (PAT) "Report on Procurement Process Reform," February 1995. The report recommended increasing the then existing threshold for requesting field pricing reports as approved by the Under Secretary of Defense for Acquisition and Technology (USD[A&T]). The PAT team concluded that audits of low-dollar cost reimbursable proposals are unnecessary

because the actual savings to the Government from identified questioned costs are limited to the fixed-fee applicable to the amount of the exception. The resulting contracts are audited later during incurred cost audits to determine the allowability and allocability of the actual costs billed to the Government.

Buying Command Procedures for Evaluating Cost Realism

Contracting officers are required to evaluate the price reasonableness of competitive proposals but are not required to request field pricing support. FAR 15.804-5 provides that COs may request cost and price information to determine the cost realism of competing offers. The FAR and DFARS include detailed information on how to analyze price, cost, or technical information but no formal procedures on how to evaluate cost realism, and DoD has no uniform guideline. The proposed FAR Case No. 95-029 makes reviews of cost realism mandatory for cost reimbursable competitive proposals. The DoD should have general acquisition guidelines for evaluating cost realism and for requesting field pricing support as part of cost realism reviews.

Requests for Cost Realism Audits. Only 2 out of 10 cost realism reviews evaluated during field visits to 7 DCAA field offices should have been requested. For 8 of the 10 DCAA reports, DCAA could have verified the proposed rates through telephone communications. The eight DCAA reports took no exceptions to contractor proposed rates. See Appendix D for a summary of available information DCAA had to verify rates.

The 4 procurement offices visited provided 12 recent source selection cases, identified in Appendix E. These cases enabled us to evaluate their standard practices for requesting audit or field pricing assistance on source selections. The analysis appeared adequate in all 12 cases. Only 3 of the 12 source selection reviews included requests for DCAA assistance, and the U.S. Army Communications Electronics Command (CECOM) requested all 3. The CECOM price analysts did not attempt to identify existing information before making requests and did not appear to consider various forms of cost and price analysis other than relying on DCAA audit procedures.

Low-Risk Competitive Proposals. The Government cannot change or adjust competitive offers due to audit exceptions. The cost realism analysis required for competitive procurements only helps to identify an MPC used to compare offers. However, none of the large source selections evaluated in our field visits disclosed a change in the successful offeror either as a result of the requested DCAA reports on cost realism or because of buying command internal reviews of cost realism. Also, although contractors did change their offers to adjust for hours proposed as a result of technical analysis and IGEs, offerors usually did not change their offers as a result of the DCAA reviews of pricing rates. Rate verification procedures had little effect on offerors' prices or selection of the successful offeror because contractors used existing rates that were either regularly audited by DCAA, resulting in no exceptions, or because cost was only one of several variables weighted to identify the company providing the best value, and cost did not carry sufficient weight to affect the selection. The DCAA audit resources were sometimes wasted because,

although more offers are generally received for competitive than for non-competitive procurements, some buying commands routinely requested detailed field pricing support as though the proposal was for a high-risk, sole-source procurement.

Inadequate or Inconsistent Guidance. The DoD has not established detailed procedures for buying organizations to follow for evaluation of cost realism. The DoD “Best Value Handbook,”³ provides nondirective guidance for evaluating cost realism. The guidance indicates that the source selection committee should use support provided with the proposal and advice from the DCAA. However, the handbook contains little additional information for evaluating cost realism. A “Cost Realism Analysis Checklist” is also available in the “Defense Acquisition Deskbook.” The checklist identifies data available from the offeror or from Government sources. However, neither the Manual nor the Deskbook identifies specific procedures and methods for analyzing cost realism. Because of the lack of DoD guidance, buying organizations have adopted unique practices to evaluate cost realism. Appendix B, “Other Matters of Interest,” briefly describes some Military Department guidance used.

The Air Force uses Source Selection Teams and has a Source Selection Department at major buying organizations. All competitive source selections included the use of IGEs as a basis to determine price reasonableness and cost realism. The Air Force generally relied on existing labor and indirect rate information from DCAA without requesting field pricing reports.

The Naval Air Systems Command (NAVAIR) procedures were inconsistent. In one procurement, the contracting officer requested informal verification of indirect rates. However, detailed requests for formal audit reports were requested for two small cost reimbursable proposals when audited rate information was already available.

The Naval Sea Systems Command (NAVSEA) Source Selection Guide provides general guidance on cost realism. However, the guidance significantly differs from Air Force guidance. Whereas the NAVSEA guidance stipulates that members of the source selection team should not perform a cost realism analysis, the Air Force includes a price analyst on the Source Selection Team.

The Army CECOM price analysts used guidance issued by the legal department or by outside consultants. The CECOM price analysts requested detailed field pricing reports without considering other cost and price analysis methods and without first determining whether information was already available to verify the labor and indirect rates. For one procurement, detailed field pricing reports were requested for all 23 proposals received in response to the solicitation although few exceptions were identified.

Over-Reliance on Field Pricing. When designing the source selection and solicitation, some buying organizations relied heavily on field pricing reports to evaluate cost realism of rates and factors without considering other forms of price and cost analysis. Cost realism techniques often did not include comparison of proposed amounts or rates and factors to the following:

³ *Best Value Handbook*, Office of the Under Secretary of Defense for Acquisition and Technology, November 1996.

Unnecessary Requests for Field Pricing Service

- o actual costs and rates previously incurred;
- o historical prices;
- o previous estimates from the same offeror;
- o competitors' current cost estimates;
- o IGE of costs and prices;
- o FPRA's;
- o ACO or audit recommended rates;
- o prices obtained for similar items through market research;
- o labor surveys and forecasts; and
- o prior proposed costs for similar tasks.

Much of the information needed to evaluate these procedures was readily available or required only informal audit assistance. As a result, significant field pricing and audit resources were wasted for unnecessary reviews and analysis.

Summary

Although management addressed its concerns regarding unnecessary oversight of price proposals in the DoD PAT "Report on Procurement Process Reform," January 1995, few report recommendations on requesting field pricing were implemented through DoD directives or incorporated into DFARS. As a result, contracting officers continue old practices of requesting audits of low risk price proposals. The DoD acquisition management needs to issue DoD policies and procedures to limit oversight costs and conserve audit resources for use where most needed. Proposed revisions in FAR Case 95-029 do not fully address the conditions observed in this evaluation as explained in our discussion on page 7, "Acquisition Guidelines." We are separately making recommendations to the FAR Secretariat to amend the proposed revisions to include a requirement that contracting officers contact the cognizant contract administration or audit office before requesting field pricing assistance. We are also recommending that information included in the current FAR and useful to determine the extent of audit support required not be excluded as proposed in the rewrite.

The Desk References in the Defense Acquisition Deskbook also do not include adequate useful information. Additional guidance is needed in the Cost Analysis Desk Reference. Procurement offices should also implement adequate standard operating procedures to ensure that common guidance is properly implemented.

Management Comments on the Finding and Evaluation Response

The USD(A&T) provided several comments on the finding. For the full text of management comments, see Part III.

USD(A&T) Comments. Management believes that sufficient policy guidance already exists and that deficiencies noted in the report will not be resolved by issuing more guidance. Pricing business practices have changed significantly during the last 2 years, and field personnel have not had an opportunity to keep up with all changes. The real issue is not lack of FAR guidance, but rather the need for continuing emphasis on education and training. Management stated we appear to misunderstand the FAR part 15 rewrite, which removed dollar thresholds because of a fundamental shift in policy with respect to field pricing assistance. The rewrite “attempted to adopt the acquisition reform principle of empowering field personnel to exercise their judgment in determining the nature and extent of the field pricing assistance they require. . . . However, it is likely that discretionary dollar thresholds will be included in proposed revisions to the DFARS to reflect the FAR part 15 rewrite.”

The comments also pointed out that the Defense Acquisition Deskbook was developed by the Offices of Acquisition Reform and Acquisition Program Integration within the Office of the Secretary of Defense and not by the AFIT and FAI. Secondly, because the report concluded that the Government cannot change or adjust competitive offers due to audit exceptions, “the DoDIG report appears to confuse cost realism analyses as they apply to cost-type and fixed-price contracts. It is true that the government cannot change or adjust competitive offers due to audit exceptions for fixed price contracts, where the results of cost realism analyses may be used only for purposes of risk assessment and responsibility determination. However, for cost-type contracts, cost realism analysis is used to determine the MPC of performance for each offeror, and the MPC must be used in evaluating offers to determine the best value proposal.”

Evaluation Response. We agree that emphasis on education and training is essential due to the pace of change in procurement and contractor administration policy. Also, the existing prescriptive guidance has not resulted in a reduction of unnecessary field pricing rework. Our objective was not to create unnecessary new guidance but to ensure that contracting officers exercise sound judgment in determining the nature and extent of information required to implement a government citation. Training and education will help ensure that field pricing is requested only when needed. We addressed dollar thresholds in the recommendations because we believe contracting officers must consider them when assessing the inherent risk of a price proposal and, therefore, the extent of field pricing support required. Any contemplated revisions to DFARS should include guidelines for assessing risk in regard to requesting audit services.

The AFIT and the FAI developed the five Desk References included in the Deskbook. We have revised the report to correct the reference to the Deskbook development.

We maintain, as stated in the report, that the Government cannot change or adjust competitive offers due to audit exceptions. The report stated also that “The cost realism analysis required for competitive procurements only helps to identify an MPC used to compare offers.” The statement does not imply that the Government can effect a downward price with the contractor, on either fixed-price or cost-type contracts, based on audit results. The Government chooses among competing offers the one that represents the best MPC.

Recommendations, Management Comments and Evaluation Response

We recommend that the Under Secretary for Acquisition and Technology:

1. Direct buying organizations to:

a. Require contracting officers or designated representatives to contact cognizant administrative and audit field offices to identify and obtain pricing information already available before requesting detailed audits and field pricing reports;

USD(A&T) Comments. Management concurred with the recommendation, stating the FAR part 15 rewrite will provide sufficient guidance to contracting officers on this matter. The new FAR coverage will be altered significantly from existing coverage to reflect new DCMC and DCAA business practices with respect to field pricing assistance. The proposed FAR subpart 15.404-2 states that “. . . contracting officers are encouraged to team with appropriate field experts throughout the acquisition process. . . Early communication with these experts will assist in determining the extent of assistance required. . . .”

Evaluation Response. Management comments are responsive to the recommendation. While the FAR part 15 rewrite alone cannot achieve the required improvements, we expect that procurement and contract administration organizations will develop local procedures to implement the new FAR part 15 and conduct required training to familiarize staff with the new provisions. Our review primarily addressed current FY 1996 field pricing assignments and evaluated the compliance with existing guidelines.

As stated in the finding, the number of DCAA agreed-upon procedure reviews are increasing. Many of the limited reviews are merely rate verifications. However, the reviews require considerably more audit resources than telephone rate verifications. In the second report to be issued as a result of this evaluation, we will address the DCAA practices.

b. Use simplified procedures, such as telephone rate confirmations, to complete field pricing when significant information is available at cognizant contract administration and audit field offices to evaluate contractor proposals;

USD(A&T) Comments. Management concurred with the recommendation, stating that the FAR part 15 rewrite will provide sufficient guidance to contracting officers on this matter. The rewrite will state that “Whenever circumstances permit, the contracting officer and field pricing experts are encouraged to use telephonic and/or electronic means to request and transmit pricing information (proposed FAR 15.404-2(b)(i).”

Evaluation Response. Management comments are responsive to the recommendation. While communications between contracting officers and auditors before the issuance of audit requests and the start of an audit are rare, especially for less complex price proposals, we are encouraged by FAR part 15 rewrite that emphasizes early communication with field experts.

However, as discussed in the report, the current FAR part 15 provisions are more specific on the requirements to tailor audit requests to prevent unnecessary audits of low-risk proposals. The existing FAR 15.805-5(a) strongly recommends that communications occur before the issuance of audit requests to determine whether information is already available. Contracting officers are also required to identify available information in order to comply with FAR 15.805-5(b) and DFARS 215.805-5(a)(1)(A) guidance, which prohibits unnecessary field pricing requests under certain monetary thresholds. Those controls are eliminated in the rewrite, which also eliminates the FAR 15.805-5(a) list of pricing information that might already be available at buying commands to avoid unnecessary requests. We remain concerned that the existing stronger FAR guidance did not result in communication and coordination on audit requests and recognize that the solution is thorough training of contracting officers in the exercise of sound judgment rather than additional guidance.

c. Require contracting officers or their representatives document reasons for requesting detailed field pricing reports on procurements below the regulatory thresholds when pricing information is available.

USD(A&T) Comments. Management nonconcurred because the proposed FAR part 15 rewrite does not include the regulatory dollar threshold, and the recommendation, therefore, serves no useful purpose.

Evaluation Response. We included this recommendation because the proposed FAR part 15 rewrite has not been finalized. Therefore, we ask that management reconsider its comments to address the present situation which will exist until the FAR part 15 rewrite is issued. Also, action taken to implement Recommendation 1.a, will address this concern. If contracting officers are required to contact auditors and consider readily available information before requesting an audit, we expect that they will request rate verifications instead of audits.

2. Direct the Air Force Institute of Technology to incorporate guidance in the Cost Analysis Desk Reference to:

a. Document examples of information available at buying commands or field offices that can be used to evaluate the reasonableness of proposals without requesting audits, including a statement of estimating

system adequacy, recent production costs, established pricing formulas, standard component prices, and audit recommended rates for labor and indirect costs;

b. Document informal procedures that are acceptable to meet field pricing requirements for low risk proposals, when information is available at the audit office, including use of telephone rate confirmations and transmission of Forward Pricing Rate Agreements and existing audit reports containing rate information;

c. Identify a sample of records and support that contracting officers responsible for evaluating proposals may request directly from contractors and comment when those records may be requested and used; and

d. Provide examples of proposals that represent high, moderate, and low pricing risk based on the type of information available and the adequacy of the estimating system.

USD(A&T) Comments. Management partially concurred but disagreed that formal direction is warranted. The suggested guidance is already under way as a result of updates to the *Contract Pricing Reference Guides* necessitated by the FAR part 15 rewrite.

Evaluation Response. The USD (A&T) response is responsive to the recommendation. The response to the final report should indicate when the updated *Contract Pricing Reference Guides* will be available. Further, we ask that the draft coverage be coordinated with us.

3. Issue guidance to remind buying activities of the common DoD guidance in the five desk references in the Defense Acquisition Deskbook and direct buying activities to modify office practices and procedures to conform with the common guidance.

USD(A&T) Comments. Management partially concurred but disagreed that the guidance should be made directive. To require buying activities to comply with “non-directional” guidance is contrary to the principles of acquisition reform that include empowerment of field personnel.

Evaluation Response. The USD (A&T) response is partially responsive to the recommendation, which was made to address the inconsistent policies, procedures, and practices for evaluating cost realism that exist among the Military Departments and buying organizations.

Military Department instructions that contradict or significantly vary from the guidance on cost realism in the *Contract Pricing Reference Guides* should be amended. It is consistent with the principles of acquisition reform to ensure that Military Departments and buying organizations use uniform, or at least similar, buying practices and procedures. For a contractor dealing with more than one Military Department, the different customer practices and procedures can only be confusing and result in wasted resources.

We request that the USD(A&T) reconsider its position in response to the final report.

4. Establish a process action team to report on reasonable methods for evaluating cost realism for source selection and document agreed-to methods.

USD (A&T) Comments. Management nonconcurred with the recommendation, stating that most of the issues raised with respect to cost realism are not related to analysis methodologies, but rather to the nature and extent of information requested to support the analyses. Management believes that the problem will be resolved by continuing education and training rather than uniform cost realism procedures. Volume IV of the *Contract Pricing Reference Guides*, Advanced Issues in Contract Pricing, contains an entire chapter on conducting a cost realism analysis, including “the nature and extent of information to request, the role of audit support and contract administration team support, and examples of analyses.” That guidance is sufficient.

Evaluation Response. Management comments may be responsive to the recommendation. The referenced Volume IV of the *Contract Pricing Reference Guides* is only in the developmental stage and, depending on its contents, could satisfy the intent of the recommendation. Management did not state when the publication will be available. We request a copy and the opportunity to comment on the sufficiency of the cost realism coverage.

Although we agree that continuing education and training is beneficial, they do not obviate the need for clear written guidelines on what constitutes best practices. Some buying organizations lacked understanding of the methods available to evaluate cost realism. Military Department instructions are inconsistent. Air Force practices made maximum use of analyses based on information that was readily available to it. Its analyses included using IGEs based on the cost history for related tasks; comparison of the labor mix, hours, and rates in competing offers; comparison of proposed costs and prices to previous bids for similar effort; comparison of rates to FRPAs; and the use of telephone rate checks. The use of field pricing or audit reports should be requested only if adequate information is not available and cost realism cannot be assessed by internal evaluation techniques.

Part II - Additional Information

Appendix A. Evaluation Process

Scope

Our evaluation covered requests for audit services issued by the Army, Navy, and Air Force buying organizations; the DCMC; and SUPSHIP contract administrative offices. We visited four procurement offices, seven DCAA field audit offices, five DCMC contract administration offices, and one SUPSHIP contract administration office and reviewed 93 requests for audit services, including 10 requests for reviews of competitive proposals. To determine the extent of audit procedures necessary to respond to the CO requests for field pricing support on a contractor proposal, we reviewed information available at the cognizant DCAA and contract administration offices, as follows:

- o Reports and workpapers on DCAA and DCMC joint estimating system surveys and DCAA internal control records documented the acceptability of contractor estimating systems and contractor actions to correct any deficiencies. A contractor with an acceptable estimating system represents low risk for forward pricing purposes, and minimal audit procedures are required.
- o Audit reports on forward pricing rates, ACO memorandums addressing forward pricing rates and documentation in audit and price analysts field pricing cases identified the information available to respond to the audit request without additional audit procedures.
- o Automation capabilities at the DCAA and DCMC locations showed whether auditors and price analysts had on-line access to contractor pricing information for easy updating of rate information and verification of proposed rates without extensive auditing.

At procurement offices, we reviewed business clearance and source selection memorandums and pricing reports to determine the extent of services requested and cost or price analyses performed by buying organizations.

Evaluation Methodology

Use of Computer-Processed Data. No computer-processed data were used in the course of the audit.

Universe and Sample. The DCAA issues price proposal audit reports based on CO requests for audit services. We, therefore, used the DCAA Agency Management Information System (AMIS) to identify field audit offices

responding to audit requests from October 1, 1995 through September 30, 1996. The DCMC and SUPSHIP contract administrative offices also respond to requests for field pricing without the assistance of DCAA audits. To identify procurement requests for DCMC field pricing, we used the DCMC pricing case logs. We also used information in the Washington Headquarters Services publication, "100 Companies Receiving the Largest Dollar Value of Prime Contract Awards, FY 1995" to identify large contractors and major weapons programs.

We visited seven DCAA field offices, six contract administration offices and four procurement offices. We reviewed 93 requests for field pricing support. Eighty-five of the 93 requests were for audit services and eight were for field pricing.

Field Visits and Sample Selection. We judgmentally selected six DCAA field offices cognizant of major contractors and associated contract administration offices located in each of the five DCAA Regions. Each office had a high volume of price proposal audit reports issued during FY 1996. The six offices at major contractor locations audited major weapons systems representing the Army, the Navy, and the Air Force. We also evaluated some small contractors at one DCAA Branch Office. At the seven DCAA offices, we judgmentally selected 85 audits of primarily low dollar (below \$10 million) proposals with few or no dollars questioned as a result of the audit. At the contract administration offices, we selected eight field pricings of low-dollar proposals for cost reimbursable contracts requested by buying commands identified at the audit offices. The 93 requests were for audits and reviews of proposals ranging in value from \$14,000 to \$440 million, and 10 requests were for reviews of competitive procurements.

We selected four procurement offices to visit based on the volume of audit requests issued to the DCAA locations. During visits to the four offices, we followed up on 20 of the 93 requests evaluated at DCAA and DCMC field visits for followup review. We also judgmentally selected for evaluation 12 large competitive procurements not included in our sample of 93.

Because the audit requests were judgmentally selected, we are not projecting the results of our evaluation on a DoD-wide basis.

Field work began in October 1996 and was completed in May 1997.

Contacts during the Evaluation. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Appendix B. Other Matters of Interest

Military Department Guidance for Evaluating Cost Realism. The Military Departments and some buying organizations followed different formal and informal guidance on evaluating cost realism. In general, the guidance provided few examples on how to evaluate cost realism. The differences in guidance contributed to inconsistent practices and contributed to unnecessary audit requests.

Air Force. The Air Force Federal Acquisition Supplement provides general requirements for performing cost realism analysis. The Air Force guidance emphasizes source selection planning and teaming responsibilities and incorporates cost realism and price analysis planning into the source selection process. The guidance also states that the purpose of analyzing cost realism is to determine whether the proposed costs are compatible with the technical approach. However, the guidance does not provide specific methods for analyzing cost realism. Buying offices are not required to use IGEs but are advised to compare IGEs to proposals, if estimates are used. The guidance also refers to DCAA and DCMC assistance without specifying what kind of assistance is appropriate or when it should be requested.

Navy Procedures. The Naval Acquisition Policy Supplement (NAPS) subpart 5215.805-70 includes procedures and examples for performing a cost realism analysis. A NAVAIR pricing handbook generally defines similar procedures. The NAPS provides that cost realism procedures for competitive procurements should differ from detailed cost analysis of noncompetitive procurements when cost and pricing data are required. According to the guidance, a price analysis with adequate price history may be suitable to evaluate cost realism. In addition, NAPS illustrative examples indicate that cost realism techniques can also include analysis of quantities of labor hours and mix, indirect and labor rates, and make or buy decisions. The NAPS subpart S-96 provides that, “When cost realism data are required, the contracting officer shall not request a formal field pricing report . . .” The guidance states that a contracting officer may only need to know the current or FPRA labor and/or overhead rates. It also advises that “In these instances, the request for information from DCAA may be oral or written.” The NAVAIR did not list other cost analysis procedures among examples for performing cost realism analysis. Also, the NAVSEA maintains its own Source Selection Guide that provides general guidance on cost realism.

Army Procedures. The Army Materiel Command (AMC) maintains general guidance in its publication, “The Best Value Approach -- Guide to Best Practices.” We evaluated cost realism practices in detail at the Army CECOM. We found the price analysts used guidance issued by the legal department or by outside consultants. The guidance most followed included the “Cost Realism Manual” guidance issued by the Professional Services Council and the specific guidance furnished by the AMC Procurement Systems Office.

The guidance in the “Cost Realism Manual” suggests a review of cost and pricing data for, “accuracy, completeness and currency.” The AMC guidance recommended using DCAA and DCMC field pricing support to the extent necessary.

Appendix C. Audit Requests by Buying Activity and Contract Type

	Audit Not Justified Number ¹	Audit Justified Number ²	Audit Not Justified Average Value	Audit Justified Average Value
<u>Cost Reimbursable:</u>				
CECOM	3	1	\$2,045,333	\$97,905,345
MICOM*		1		Indefinite
NAVAIR	3	3	\$3,367,449	\$19,361,215
NAVSEA	1	1	\$837,855	\$55,787,742
SUPSHIP	4	1	\$2,263,391	\$889,000 ²
Other Navy	1	1	\$6,802,973	\$107,000 ³
ASC**	7			\$3,583,940
SMC***	2	1	\$1,641,500	\$622,108 ⁴
DCMC	12	1	\$2,637,336	\$1,281,336
Other	2	1	\$1,612,540	\$1,952,547
<u>Fixed-Price, Incentive, Time & Materials:</u>				
CECOM	1	3	\$524,000	\$48,762,242
MICOM	1		\$840,830	
NAVSEA		5		\$40,372,792
SUPSHIP	2		\$265,304	
Other	2		\$2,019,214	
ASC	5	3	\$363,980	\$13,942,452
SMC	1		\$14,481	
DCMC	<u>7</u>	<u>7</u>	\$686,382	\$ 4,506,038
Total Requests	54	29		

Appendix C. Audit Requests by Buying Activity and Contract Type

¹ Audits were considered not justified because the proposals were labor intensive with little or no materials and current rate information was available from the ACO or DCAA. Unjustified audit requests also included several requests that involved merely verifying actual costs incurred for the contract or bid and proposal costs when accounting records were readily available to DCAA.

² DFAS 215.805-5(a)(1)(A)/FAR 15.805-5(b) stipulate that field pricing requests should not be made on cost reimbursable proposals under \$10 million when estimating systems are adequate and pricing information is available to evaluate the reasonableness of the proposal.

³ The Office of Naval Research requested only a rate verification. The auditors disagreed and concluded that the contractor bid unallowable overtime rates. The DCAA decided to use detailed procedures and questioned the overtime labor.

⁴ All costs examined were primarily limited to a bill of materials.

- * MICOM - United States Army Missile Command
- ** ASC - Aeronautical Systems Center, Wright-Patterson Air Force Base
- *** SMC - Space and Missile Systems Center

Appendix D. Requests for Cost Realism Reviews

<u>Request Number</u>	<u>Buying Organization</u>	<u>Request Amount</u>	<u>Information Necessary</u>	<u>Available</u>
1	AVCOM ¹	\$5,000,000	No	Audited forward pricing rates available, no exceptions
2	TACOM ²	\$2,001,017	No	Auditors on site, numerous recent audits actual rates available, no exceptions
3	CECOM	\$36,800,000	No	DCMC approved rates available and on-line access to direct costs, no exceptions
4	CECOM	\$24,400,000	No	This is the final proposal for the previous procurement, no exceptions
5	WNY ³	\$13,183,484	No	Rates available, 7 audits per fiscal year, only 1 labor rate verified by name, no exceptions
6	NAVSEA	\$546,415	Yes	No recent experience
7	NAVSEA	\$440,260,697	Yes	Complex proposal for a new product line
8	WRAFB ⁴	\$11,265,627	No	DCMC recommended labor and indirect rates, auditors on site
9	KAFB ⁵	\$5,223,171	No	Audit recommended rates, auditors on site
10	DCMC	\$2,600,000	No	Rates available from recent audit, no exceptions

Appendix D. Requests for Cost Realism Reviews

¹	AVCOM	United States Army Aviation and Troop Command
²	TACOM	United States Army Tank-Automotive Command
³	WNY	Washington Navy Yard
⁴	WRAFB	Warner Robbins Air Force Base
⁵	KAFB	Kirkland Air Force Base

Appendix E. Source Selections

<u>Buying Organization/ Source Selection No.</u>	<u>Amount Proposed</u>	<u>Evaluation Method(s)</u>
Space Missiles Command:		
1	\$44,238,497	(a)
2	\$1,626,920,715	(a), (b)
3	\$449,181,929	(a), (b)
4	\$19,253,302	(c)
5	\$9,000,000	(c)
Wright-Patterson:		
6	\$594,649,758	(a)
7	\$49,286,336	(a)
8	\$286,665,832	(c)
CECOM:		
9	\$72,629,688	(d)
10	\$275,000,000	(d)
11	\$58,000,000	(d)
NAVAIR:		
12	\$5,000,000	(a), (b)

- (a) Price analysis comparison between IGE and/or other offers.
- (b) Informal DCAA rate verification without a detailed report.
- (c) Comparisons between offeror's prices and costs and/or market pricing.
- (d) Formal DCAA requests for audit services.

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Deputy Under Secretary of Defense (Acquisition Reform)
Director, Defense Logistics Studies Information Center
Director, Defense Procurement
Under Secretary of Defense (Comptroller)
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Assistant Secretary of the Army (Research, Development, and Acquisition)
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Assistant Secretary of the Navy (Research, Development and Acquisition)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Commander, Defense Contract Management Command

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Government Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice,
Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Under Secretary of Defense for Acquisition and Technology Comments



ACQUISITION AND
TECHNOLOGY

DP/CPF

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

September 19, 1997

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT
POLICY AND OVERSIGHT, DOD INSPECTOR GENERAL

THROUGH: CONGRESSIONAL ACTIONS AND INTERNAL REPORTS/API

SUBJECT: DoDIG Draft Report on Evaluation of DoD Requests for
Field Pricing Audit Support (Project No. 60C-0086)

This is in response to your request of August 7, 1997, to provide comments on the subject draft report. Our comments are provided in the attachment.

A handwritten signature in cursive script that reads "Eleanor R. Spector".

Eleanor R. Spector
Director, Defense Procurement

Attachment

**DODIG DRAFT REPORT ON
EVALUATION OF DOD REQUESTS FOR
FIELD PRICING AUDIT SUPPORT
(PROJECT NO. 6OC-0086)**

**OFFICE OF THE UNDER SECRETARY OF DEFENSE
(ACQUISITION AND TECHNOLOGY)**

COMMENTS ON SELECTED FINDINGS

EVALUATION OBJECTIVES. The overall objective of the DoDIG review was to evaluate the process used by contracting officers (COs) and administrative contracting officers (ACOs) to request Defense Contract Audit Agency (DCAA) reviews of contractor price proposals, with emphasis on major programs, and the adequacy of the reviews. The review also assessed the adequacy of management control procedures at DCAA field audit offices, DoD contract administration offices, and Military Department procurement commands for determining the scope of requested audit assistance.

EVALUATION RESULTS. The DoDIG concluded that CO/ACO requests for audit and the scope of the requested services were appropriate for large contract price proposals above the FAR/DFARS dollar threshold for requesting field pricing review when cost or pricing data were required. The DoDIG reported that price analysts at procurement offices adequately determined cost realism for 12 large, competitive procurements before selecting the contractor.

The DoDIG also concluded that COs/ACOs requested unnecessary audits or reviews and detailed field pricing reports on cost or pricing data in noncompetitive contract price proposals below the FAR/DFARS dollar threshold for requesting field pricing support for 54 out of 83, or 65 percent, of the requests reviewed. The DoDIG reported that sufficient pricing information to evaluate the reasonableness of cost or pricing data in proposals without field pricing reports was already available at the buying command, the cognizant contract administrative office, or the DCAA audit office.

In addition, the DoDIG concluded that 8 out of 10 cost realism reviews were unnecessary because information was already available to complete the pricing action (page i, paragraph 4).

RESPONSE. The DoDIG review may be timely in highlighting the continuing need for education and training of the workforce, particularly with respect to the type and extent of information

ATTACHMENT

necessary to support proposal analysis. However, sufficient policy guidance exists and this problem will not be resolved by issuing more guidance. Pricing business practices have significantly changed, especially within the last two years. It has been difficult for field personnel to accomplish their buying tasks while attempting to keep current with the changes brought about by the Federal Acquisition Streamlining Act of 1994 (FASA), the Clinger-Cohen Act, DCAA and DCMC business practice reengineering, and the FAR Part 15 rewrite. Field personnel do not need additional policy guidance; they need the time to assimilate the guidance that already exists.

FINDING. The DoDIG review acknowledges that the FAR "...stipulates that CO requests for field pricing support should be tailored to ask for the minimum information necessary to ensure a fair and reasonable price" (page 2, paragraph 2), and that "A significant number of requests were not properly tailored to the minimum information required to complete the pricing action" (page i, paragraph 4).

RESPONSE. The real issue is not lack of FAR guidance but rather the need for a continuing emphasis on education and training--a need that has been increased by the recent frequent and sweeping changes to pricing policies.

FINDING. The DoDIG notes that the Defense Acquisition Deskbook was developed by the Air Force Institute of Technology and the Federal Acquisition Institute and that reference guides provide guidance for price and cost analysts (page 6, paragraph 4).

RESPONSE. As a point of clarification, the discussion of the Defense Acquisition Deskbook is incorrect in several places. The Deskbook was not developed by the Air Force Institute of Technology and the Federal Acquisition Institute. Rather, the Deskbook was developed by the Offices of Acquisition Reform and Acquisition Program Integration within the Office of the Secretary of Defense. The organizations credited with development merely provided inputs as did many other offices and organizations. Furthermore, several reference guides are described as providing guidance. These reference guides do not provide guidance; rather they provide discretionary information and should be considered informational only.

FINDING. The DoDIG acknowledges that the proposed FAR Part 15 rewrite removes the threshold restrictions on field pricing requests for low-risk/low-dollar proposals (page 7, paragraph 3).

RESPONSE. The DoDIG appears to misunderstand the FAR Part 15 rewrite and DCAA and DCMC business practice changes. The dollar thresholds were removed because of a fundamental shift in policy with respect to field pricing assistance. Rather than continuing with mandatory thresholds, the rewrite attempted to adopt the acquisition reform principle of empowering field personnel to exercise their judgment in determining the nature and extent of the field pricing assistance they require. To support this policy shift, "cookbook" approaches were replaced with concepts such as early teaming of buying activities with DCMC and DCAA, use of streamlined methods such as telephonic and other electronic means to request and transmit information, and replacement of standard field pricing reports with tailored field pricing assistance. However, it is likely that discretionary dollar thresholds for contracting officer consideration will be included in proposed revisions to the DFARS to reflect the Part 15 rewrite.

FINDING. The DoDIG notes that the proposed FAR Part 15 rewrite to abolish the dollar thresholds is contrary to Recommendation 5 of the DoD Process Action Team (PAT) "Report on Procurement Process Reform," dated February 1995 (page 7, paragraph 4).

RESPONSE. The DoDIG report fails to recognize that the PAT team formulated its recommendations with a baseline of regulations and business practices that were substantially different from those that exist today. Current pricing policies and practices go well beyond the PAT team's recommendations in streamlining the process and discouraging contracting officers from obtaining unnecessary information.

FINDING. The DoDIG report notes that the DoD should have general acquisition guidelines for evaluating cost realism and for requesting field pricing support as part of cost realism reviews (page 8, paragraph 2).

RESPONSE. Volume IV of the *Contract Pricing Reference Guides, Advanced Issues in Contract Pricing*, has been recently updated through FAC 90-46, dated March 17, 1997. This volume contains an entire chapter on conducting a cost realism analysis, including the nature and extent of information to request, the role of audit support and contract administration team support, and examples of analyses. We believe this guidance is sufficient.

FINDING. The DoDIG states that the government cannot change or adjust competitive offers due to audit exceptions (page 8, paragraph 5)

RESPONSE. The DoDIG report appears to confuse cost realism analyses as they apply to cost-type and fixed price-type contracts. It is true that the government cannot change or adjust competitive offers due to audit exceptions for fixed price contracts, where the results of cost realism analyses may be used only for purposes of risk assessment and responsibility determinations. However, for cost-type contracts, cost realism analysis is used to determine the most probable cost of performance for each offeror. The most probable cost must be used in evaluating offers to determine the best value proposal.

OFFICE OF THE UNDER SECRETARY OF DEFENSE
(ACQUISITION AND TECHNOLOGY)

COMMENTS ON RECOMMENDATIONS

RECOMMENDATION 1. The DoDIG recommends that the Under Secretary of Defense for Acquisition and Technology direct buying organizations to:

a. Require contracting officers or designated representatives to contact cognizant administrative and audit field offices to identify and obtain pricing information already available before requesting detailed audits and field pricing reports;

RESPONSE. Concur because the FAR Part 15 rewrite will provide sufficient guidance to contracting officers on this matter. The new FAR coverage will be altered significantly from existing coverage to reflect new DCMC and DCAA business practices with respect to field pricing assistance. The new coverage specifically states that "...contracting officers are encouraged to team with appropriate field experts throughout the acquisition process, including negotiations. Early communication with these experts will assist in determining the extent of assistance required, the specific areas where assistance is needed, a realistic review schedule, and the information necessary to perform the review (proposed FAR 15.404-2(a)(3))."

b. Use simplified procedures, such as telephone rate confirmations, to complete field pricing when significant information is available at cognizant contract administration and audit field offices to evaluate contractor proposals;

RESPONSE. Concur because the FAR Part 15 rewrite will provide sufficient guidance to contracting officers on this matter. The rewrite will state that "Whenever circumstances permit, the contracting officer and field pricing experts are encouraged to use telephonic and/or electronic means to request and transmit pricing information (proposed FAR 15.404-2(b)(i))."

c. Require contracting officers or their representatives document reasons for requesting detailed field pricing reports on procurements below the regulatory thresholds when pricing information is available.

Under Secretary of Defense for Acquisition and Technology

RESPONSE. Nonconcur. The new FAR Part 15 coverage no longer includes the regulatory dollar thresholds. This recommendation serves no useful purpose.

RECOMMENDATION 2. The DoDIG recommends that the Under Secretary of Defense for Acquisition and Technology direct the Air Force Institute of Technology to incorporate guidance in the Cost Analysis Desk Reference to:

a. Document examples of information available at buying commands or field offices that can be used to evaluate the reasonableness of proposals without requesting audits, including a statement of estimating system adequacy, recent production costs, established pricing formulas, standard component prices, and audit recommended rates for labor and indirect costs;

b. Document informal procedures that are acceptable to meet field pricing requirements for low risk proposals, when information is available at the audit office, including use of telephone rate confirmations and transmission of Forward Pricing Rate Agreements and audit reports on rate information;

c. Identify a sample of offeror records and support that contracting officers responsible for evaluating proposals may request directly from contractors and comment when those records may be requested and used; and

d. Provide examples of proposals that represent high, moderate, and low pricing risk based on the type of information available and the adequacy of the estimating system.

RESPONSE. Partially concur. Formal USD(A&T) direction is not warranted. The suggested guidance is already underway as a result of updates to the Contract Pricing Reference Guides necessitated by the FAR Part 15 rewrite. The Contract Pricing Reference Guides are a joint effort between the Air Force Institute of Technology and the Federal Acquisition Institute.

RECOMMENDATION 3. The DoDIG recommends that the Under Secretary of Defense for Acquisition and Technology issue guidance to remind buying activities of the common DoD guidance in the five desk references in the Defense Acquisition Deskbook, and direct buying activities to modify office practices and procedures to conform with the common guidance.

RESPONSE. Partially concur. We have no objection to a reminder to the field activities that the Contract Pricing Reference Guides represent an excellent resource for pricing guidance and

recommended practices. However, we disagree with the recommendation that this guidance be made directive. As noted in the DoDIG report (page 6, paragraph 4), the "reference guides provide non-directional guidance, instruction, discussion, and examples on applying pricing policies." Requiring buying activities to comply with this "non-directional" guidance is contrary to the principles of acquisition reform that include empowerment of field personnel. Contracting officers must be permitted to exercise sound business judgment if acquisition reform is to succeed. Turning the Contract Pricing Reference Guides into quasi-regulations would represent a return to pre-reform thinking and cause many of the same problems acquisition reform was meant to solve.

RECOMMENDATION 4. The DoDIG recommends that the Under Secretary of Defense for Acquisition and Technology establish a process action team to report on reasonable methods for evaluating cost realism for source selection and document agreed-to methods.

RESPONSE. Nonconcur. It appears that most of the issues raised in the DoDIG report with respect to cost realism are not related to analysis methodologies but rather to the nature and extent of information requested to support these analyses. This problem will be resolved by continuing education and training, not uniform cost realism procedures. Volume IV of the Contract Pricing Reference Guides, Advanced Issues in Contract Pricing, contains an entire chapter on conducting a cost realism analysis, including the nature and extent of information to request, the role of audit support and contract administration team support, and examples of analyses. We believe this guidance is sufficient.

Audit Team Members

This report was prepared by the Contract Audit Directorate, Office of the Assistant Inspector General for Policy and Oversight, DoD.

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