Audit Report

OFFICE OF THE INSPECTOR GENERAL

COMPLAINT TO THE DEFENSE HOTLINE ON SOLE-SOURCE SECTION 8(a) CONTRACTS AT THE NAVAL AIR SYSTEMS COMMAND

Report No. 96-059 January 16, 1996

Department of Defense

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Acronyms

CFR	Code of Federal Regulations
FAR	Federal Acquisition Regulation
NAVAIR	Naval Air Systems Command
SBA	Small Business Administration

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

January 16, 1996

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Audit Report on Complaint to the Defense Hotline on Sole-Source Section 8(a) Contracts at the Naval Air Systems Command (Report No. 96-059)

We are providing this audit report for review and comment. This report is the first of two on our audit of sole-source Section 8(a) contracts and questionable labor costs charged to contracts at the Naval Air Systems Command. We conducted the audit in response to a complaint to the Defense Hotline. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Commander, Naval Air Systems Command, provide additional comments on the unresolved Recommendation 1 and the related potential monetary benefits by March 18, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Terry L. McKinney, Audit Program Director, at (703) 604-9288 (DSN 664-9288) or Mr. Henry F. Kleinknecht, Audit Project Manager, at (703) 604-9324 (DSN 664-9324). See Appendix H for the report distribution. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 96-059 **January 16, 1996**
Project No. 5CF-7002

Complaint to the Defense Hotline on Sole-Source Section 8(a) Contracts at the Naval Air Systems Command

Executive Summary

Introduction. This report is the first of two reports in response to a complaint to the Defense Hotline about work being improperly directed by a program manager to a Section 8(a) contractor on a sole-source basis and about questionable labor costs charged to DoD contracts. This report discusses sole-source Section 8(a) contracts awarded by the Small Business Administration for the Naval Air Systems Command. The Federal Acquisition Regulation requires that acquisitions offered for award pursuant to Section 8(a) of the Small Business Act be awarded on the basis of competition restricted to eligible program participants if the anticipated award price of the contract (including options) will exceed $3 million. The Small Business Administration had issued supplemental guidance that allowed the $3 million threshold to apply to the guaranteed minimum value of the contract for indefinite-delivery, indefinite-quantity type contracts. In May 1993, the Director, Defense Procurement, issued a DoD memorandum instructing contracting officers not to use the Small Business Administration guidance to circumvent competition requirements. Effective August 7, 1995, the Small Business Administration amended its guidance to eliminate the guaranteed minimum value rule for indefinite-delivery, indefinite-quantity contracts because the rule was being abused. From June 1993 through June 1994, the Small Business Administration awarded for the Naval Air Systems Command (NAVAIR) 11 indefinite-delivery, indefinite-quantity contracts to Section 8(a) program participants, each with an estimated value that exceeded $3 million. Based on recommendations from NAVAIR, five contracts were competed and six contracts were awarded on a sole-source basis.

Audit Objectives. The primary audit objective was to determine whether work was improperly assigned to a contractor on a sole-source basis, as alleged in the complaint to the Defense Hotline. In addition, we determined whether NAVAIR was recommending competition for individual Section 8(a) contracts with anticipated award prices greater than $3 million. The audit also evaluated the NAVAIR management control program as applicable to the audit objectives.

Audit Results. We did not substantiate the complaint that work was improperly directed by a program manager to a contractor on a sole-source basis. Details of the allegation are discussed in Appendix C. A subsequent report will discuss the questionable labor costs charged to DoD contracts.

NAVAIR inappropriately recommended to the Small Business Administration the sole source award of six Section 8(a) indefinite-delivery, indefinite-quantity contracts, each with an anticipated award price that exceeded $3 million. As a result, NAVAIR paid about 30 percent more for labor costs on the sole-source contracts than it would have paid if the work had been competed among eligible Section 8(a) program participants. Implementing the recommendations would allow NAVAIR to reduce costs by about $45.7 million for FYs 1996 through 2001 by obtaining competition on all Section 8(a) contracts with anticipated award prices that exceeded $3 million. The management

control program could be improved in that we identified a material weakness related to NAVAIR headquarters not performing the scheduled reviews of the major program assessable units identified in the management control plan. See Part I and Appendix A for the details of our review. See Appendix F for a summary of potential benefits resulting from the audit.

Summary of Recommendations. We recommend that the Commander, NAVAIR, require contracting officers and the small business representative to base competition decisions for Section 8(a) procurements on an anticipated contract award price of 95 percent (or other appropriate percent based on historic funding levels) of the maximum contract amount, and require contracting officers and the small business representative to recommend to the Small Business Administration competition for Section 8(a) procurements with anticipated award prices greater than $3 million. We also recommend that the Commander, Naval Air Systems Command, fully implement a management control program.

Management Comments. NAVAIR concurred with the intent of the recommendation to require contracting officers and the small business representative to recommend competition for Section 8(a) contracts with anticipated award prices greater than $3 million. NAVAIR also concurred with the recommendation to fully implement a management control program. NAVAIR nonconcurred with the recommendation to base Section 8(a) competitive threshold decisions on a percentage of the maximum contract amount determined by historic contract funding levels. NAVAIR stated that it uses 100 percent of the "good faith estimate of the total value" to determine the anticipated contract award price for Section (a) competition purposes. NAVAIR also nonconcurred with the potential monetary benefits stating that the amended guidance from the Small Business Administration was in effect before the draft audit report was received and that NAVAIR was in compliance with the guidance. See Part I for a summary of management comments on the recommendations and monetary benefits, Appendix E in Part II for a summary of management comments on the finding, and Part III for the full text of management comments.

Audit Response. The concurrence by NAVAIR to fully implement the management control program by July 30, 1996, once the office has been fully staffed, is responsive. However, we remain concerned that NAVAIR has placed insufficient emphasis on the management control program as shown by the failure of NAVAIR to complete any of the scheduled reviews of "high risk" assessable units during FYs 1993, 1994, 1995 and now 1996. We disagree with NAVAIR that the use of 100 percent of the "good faith estimate of the total value" will satisfy the intent of the requirement to compete Section 8(a) procurements with anticipated contract award prices greater than $3 million. The good faith estimate is an arbitrary percentage of the maximum contract amount no different than the guaranteed minimum values previously used by NAVAIR which ranged from 10 to 50 percent of the maximum contract amount. A far more reliable good faith estimate would be a percentage of the maximum contract amount based on historic funding levels. The use of the good faith estimate by NAVAIR will result in NAVAIR awarding sole-source Section 8(a) contracts that get funded for amounts greater than $3 million. That will restrict competition and appears to be a "business as usual" approach that will not satisfy the intent of the amended regulation. We also disagree with NAVAIR that since the amended regulation was in effect before the draft report was issued and since NAVAIR was in compliance with the regulation, that there would be no monetary benefits resulting from the audit. We request NAVAIR reconsider its positions on Recommendation 1 and the potential monetary benefits and provide comments on the final report by March 18, 1996.

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Part I - Audit Results

Introduction

The audit was conducted in response to a complaint to the Defense Hotline. This report is the first of two reports on the audit and discusses the competition procedures for Section 8(a) procurements greater than $3 million at the Naval Air Systems Command (NAVAIR). A subsequent report will discuss labor charges on prime contracts and subcontracts with a specific support service contractor.

Audit Background

Origin of the Section 8(a) Program. The Section 8(a) program was designed to afford small businesses that are owned by minorities and other socially and economically disadvantaged individuals an equitable opportunity to compete for contracts that they can perform to an extent consistent with the Government's financial interests. Eligible businesses have a maximum of 9 years in which they can participate in the Section 8(a) program. The Small Business Act (United States Code, title 15, section 637 [15 U.S.C. 637]) assigned the Small Business Administration (SBA) responsibility over the administration of the program. Government agencies establish contracts with SBA, who then subcontracts work for performance by eligible Section 8(a) firms.

Naval Air Systems Command Section 8(a) Program. From FYs 1990 through 1994, NAVAIR funded contracts totaling $289.5 million to Section 8(a) program participants, $178.5 million of which were time-and-materials contracts. Sole-source time-and-materials contracts greater than $3 million totaled $137.6 million, sole-source time-and-materials contracts less than $3 million totaled $21.7 million, and competitive time-and-materials contracts totaled $19.2 million. Sole-source Section 8(a) time-and-materials contracts greater than $3 million were also indefinite-delivery, indefinite-quantity contracts.

Table 1 shows the amounts funded by NAVAIR to Section 8(a) program participants.

Table 1. NAVAIR Funding to Section 8(a) Program Participants

	Millions				
	Total	Time-and-Materials Contracts			
Fiscal Year	Value of Contracts	Sole-Source (>$3 Million)	Sole-Source (<$3 Million)	Competitive	Total
1990	$ 51.0	$ 27.9	$ 4.9	$ 0.0*	$ 32.8
1991	56.7	25.3	3.1	1.6	30.0
1992	59.9	26.5	5.0	2.3	33.8
1993	62.1	29.2	4.8	3.8	37.8
1994	59.8	28.7	3.9	11.5	44.1
Total	**$289.5**	**$137.6**	**$21.7**	**$19.2**	**$178.5**

*The Federal Acquisition Regulation requirement for competition of Section 8(a) contracts greater than $3 million went into effect on November 30, 1989.

Naval Air Systems Command Section 8(a) Indefinite-Delivery, Indefinite-Quantity Contracts. From June 1993 through June 1994, SBA awarded for NAVAIR 11 Section 8(a) indefinite-delivery, indefinite-quantity contracts, each with anticipated award prices in excess of $3 million. Five contracts were awarded based on competition and six contracts were awarded sole-source.

Table 2 shows the five competitive contracts and the estimated maximum labor costs. Other direct costs were not included in the contract estimated costs.

Table 2. Estimated Maximum Labor Costs For Competitive Section 8(a) Contacts

	Millions						
	1993	1994	1995	1996	1997	1998	Total
Contract Number							
N00019-93-D-0184	$1.9	$1.9	$1.9	$2.0	$2.0	-	$9.7
N00019-93-D-0206	-	1.4	1.5	1.5	1.5	$1.5	7.4
N00019-94-D-0019	-	1.0	1.4	1.7	1.7	1.8	7.6
N00019-94-D-0030	-	1.4	1.4	1.5	1.5	1.5	7.3
N00019-94-D-0060	-	1.9	2.0	2.0	2.1	2.1	10.1
Total	**$1.9**	**$7.6**	**$8.2**	**$8.7**	**$8.8**	**$6.9**	**$42.1**

Table 3 shows the six sole-source contracts and the estimated maximum labor costs. Again, other direct costs were not included in the contract estimated costs.

Table 3. Estimated Maximum Labor Cost For Sole-Source Section 8(a) Contacts

	Millions					
	1993	1994	1995	1996	1997	Total
Contract Number						
N00019-93-D-0104	$1.4	$ 1.4	$ 1.5	$1.5	$1.6	$7.4
N00019-93-D-0110	-	2.5	2.5	2.6	-	7.6
N00019-93-D-0126	1.0	1.0	1.1	1.1	1.2	5.4
N00019-94-D-0093	-	4.0	-	-	-	4.0
N00019-94-D-0129	-	3.0	3.0	-	-	6.0
N00019-94-D-0203	-	1.8	1.9	2.0	-	5.7
Total	**$2.4**	**$13.7**	**$10.0**	**$7.2**	**$2.8**	**$36.1**

Audit Objectives

The primary audit objective was to determine whether work was improperly assigned to a contractor on a sole-source basis, as alleged in the complaint to the Defense Hotline. In addition, we determined whether NAVAIR recommended competition for individual Section 8(a) contracts with anticipated award prices greater than $3 million. We also examined the NAVAIR management control program as it applied to the other audit objectives. See Appendix A for a discussion of the audit scope, methodology, and management control program. Appendix B summarizes prior coverage related to the audit objectives. See Appendix C for a discussion of the unsubstantiated complaint to the Defense Hotline.

Sole-Source Section 8(a) Contracts Greater Than $3 Million

NAVAIR inappropriately recommended to SBA the sole-source award of six Section 8(a) indefinite-delivery, indefinite-quantity contracts, each with an anticipated award price greater than $3 million. Sole-source Section 8(a) contracts were not competed because NAVAIR contracting officers and the small business representative either used the Small Business "guaranteed minimum value" rule to allow them to avoid competition or believed that the anticipated contract award price was the guaranteed minimum contract amount. NAVAIR also had not fully implemented an effective management control program. As a result, NAVAIR paid about 30 percent more for labor costs on sole-source Section 8(a) contracts than it would have paid if the work had been competed among Section 8(a) participants. In addition, labor categories on the competed contracts had higher education and experience requirements than the sole-source contracts. NAVAIR could reduce costs by about $45.7 million over 6 years if Section 8(a) contracts with anticipated award prices that exceeded $3 million were competed.

Competition Requirements for Section 8(a) Contracts

Public Law. The Business Opportunity Development Reform Act of 1988 was enacted to improve the growth and development of small business concerns. It contained certain corrective measures to restore integrity to the Section 8(a) program, one of which was the injection of competition for large dollar contracts. Section 637(a)(1)(D)(i) of 15 U.S.C. was added to provide the new requirement:

> A contract opportunity offered for award pursuant to this subsection shall be awarded on the basis of competition restricted to eligible Program Participants if-
>
> (I) there is a reasonable expectation that at least two eligible Program Participants will submit offers and that award can be made at a fair market price; and
>
> (II) the anticipated award price of the contract (including options) will exceed $5,000,000 in the case of a contract opportunity assigned a standard industrial classification code for manufacturing and $3,000,000 (including options) in the case of all other contract opportunities.

Code of Federal Regulations. Code of Federal Regulations (the Code), title 13, section 124.311 (13 CFR 124.311), developed by SBA, allowed contracting officers to award indefinite-delivery, indefinite-quantity contracts using a guaranteed minimum value rule without regard to the competition thresholds required by Federal Acquisition Regulation (FAR) 19.805, "Competitive 8(a),"

(1), "General." The Code states the same requirements as the public law does, but adds, "For purposes of indefinite quantity/delivery contracts, the thresholds will be applied to the guaranteed minimum value of the contract."

Recent CFR Rule Change. SBA recently determined that the guaranteed minimum value rule was being improperly used to avoid competition. Effective August 7, 1995, SBA amended 13 CFR 124.311(a)(2) to eliminate the guaranteed minimum value rule.

Federal Acquisition Regulation. FAR subpart 19.805, "Competitive 8(a)," sets the dollar thresholds on Section 8(a) contracts that must be awarded through competition. Subpart 19.805-1, "General," states the same requirements as the public law and does not mention any special rules for indefinite-delivery, indefinite-quantity contracts as the CFR does.

Office of the Under Secretary of Defense and Department of the Navy Memorandum. In response to a recommendation made in an Inspector General, DoD, audit report, on May 4, 1993, the Director, Defense Procurement, issued a memorandum admonishing contracting officers against using 13 CFR 124.311 to circumvent the requirement for competition as outlined in FAR 19.805-1. The memorandum required that contracting officers pay close attention to the use of indefinite-delivery, indefinite-quantity type contracts for Section 8(a) procurements, and ensure that the use of that contract type was appropriate and that it was not used to circumvent competition requirements.

On May 20, 1993, the Director, Procurement Policy, Department of the Navy, issued a memorandum throughout the Navy procurement arenas reiterating the instruction issued by the Director, Defense Procurement.

Anticipated Award Price for Sole-Source Section 8(a) Contracts

NAVAIR inappropriately recommended to SBA the sole-source award of six Section 8(a) indefinite-delivery, indefinite-quantity contracts, each with an anticipated award price that exceeded $3 million. NAVAIR contracting officers established guaranteed minimum contract amounts for the six contracts that ranged from 10 to 50 percent of the maximum contract amount. The guaranteed minimum contract amounts were based on minimum requirements or funding levels, were significantly less than the amounts obligated on the contracts, and were basically the amounts that the program offices could guarantee based on funding availability.

The maximum contract amounts were based on actual requirements, appeared to be the amount that the Government was fairly certain to order, and were significantly more than the $3-million competition threshold. We determined that the sole-source contracts were funded at 91 percent of the maximum contract amount and that competed contracts were funded at 100 percent of the

maximum contract amounts. In some cases, the funding exceeded the maximum contract amounts because other direct costs were included in the obligated amounts, but were not in the maximum contract values established at the time that the contracts were awarded. The 11 contracts reviewed were funded at about 95 percent of the maximum contract amount.

Table 4 shows that, for each contract, the obligated base year amount was almost equal to the maximum base year contract amount and was more than the minimum total contract amount for three of the contracts. In addition, for one contract, the minimum contract amount exceeded the $3-million competition threshold.

Table 4. Estimated Labor Costs and Obligated Amounts on NAVAIR Sole-Source Section 8(a) Contracts

Contract Number	Number of Contract Years	Total Contract Amount (millions) Maximum	Total Contract Amount (millions) Minimum	Base Year Contract Amount (millions) Maximum	Base Year Contract Amount (millions) Obligated[1]
N00019-93-D-0104	5	$ 7.4	$ 3.7	$ 1.4	$ 1.4
N00019-93-D-0110	3	7.6	2.8	2.5	2.9
N00019-93-D-0126	5	5.4	2.7	1.0	1.1
N00019-94-D-0093	1	4.0	2.0	4.0	4.1
N00019-94-D-0129	3	8.0	0.9	3.0	2.0
N00019-94-D-0203	3	5.7	2.9	1.8	1.0[2]
Total		**$38.1**	**$15.0**	**$13.7**	**$12.5**

[1]Base year obligated amounts include funds for travel and other direct costs, which average 7 percent of labor costs.
[2]Base year was extended 6 months until January 1996 (18 month base period) due to the inability of the program office to meet the minimum contract guarantee of 50 percent within the original base period.

Decision to Award Sole-Source Contracts

Contracting Officer Responsibilities. The NAVAIR contracting officers used the guaranteed minimum value rule to establish minimum contract amounts that were based on funding levels that the program offices could guarantee. Contracting officers used the guaranteed minimum value rule either to allow them to avoid competition or because they believed that the anticipated contract award price was the guaranteed minimum contract amount. The contracting officers stated that they believed that at the time the contracts were awarded, they could only be certain of the minimum value of the contract, and they believed that the anticipated contract award price was the guaranteed minimum contract amount. Contracting officers are responsible for determining the proper contract type to satisfy the Government's requirements. Indefinite-delivery, indefinite-quantity contracts are appropriate when the Government cannot predetermine above a minimum amount the amount of services that will

be required during the contract period. For four of the six sole-source indefinite-delivery, indefinite-quantity contracts, the maximum contract amounts were the amounts of services that were required during the contract period. Contracting officers indicated that their decisions were based on the desire of program officers to maintain continuity in their programs on time constraints that made contract competition difficult and on heavy workloads. Five of the six sole-source indefinite-delivery, indefinite-quantity contracts were awarded to the same contractors (one contractor became a major subcontractor) that had previously provided the services. Effective August 7, 1995, SBA changed its guidance to close the loophole that had existed by removing the "guaranteed minimum value" rule and now states that competition should be based on the anticipated award price. We believe that, based on historic funding amounts, contracting officers and the small business representative should define the anticipated award price of NAVAIR Section 8(a) contracts as 95 percent (or other appropriate percent) of the maximum contract value and that contracting officers should recommend competition for Section 8(a) procurements with anticipated award prices greater than $3 million.

Small Business Representative Responsibilities. The NAVAIR small business representative was responsible for offering the procurements to SBA either on the basis of competition or on a sole-source basis. The small business representative basically followed the contracting officer's lead and did not request competition unless competition was proposed by the contracting officer. Consequently, the Commander, NAVAIR, should require its small business representative to offer to SBA, on the basis of competition, Section 8(a) contracts with anticipated award prices greater than $3 million.

Management Control Program at NAVAIR

NAVAIR had not fully implemented a management control program. In December 1992, NAVAIR developed a management control plan with 82 assessable units. NAVAIR gave a medium risk assessment and scheduled a review of competitive and sole-source procurements for 1997. For FYs 1993, 1994, and 1995, NAVAIR had scheduled 40 reviews of assessable units (11 high risk areas), but none of the reviews were performed. The management control officer stated that the reviews were not performed because of inadequate staffing. The Commander, NAVAIR, needs to fully implement a management control program and ensure that reviews of assessable units are performed.

Benefits From Competition

Reason for Competition. With the Competition in Contracting Act, Congress clearly established an "absolute preference" for competition. Various statutes and regulations on competition were designed to give an equal right to all persons to compete for Government contracts; to prevent unjust favoritism,

collusion, or fraud in the letting of Government contracts; and to secure for the Government the benefits of competition. Competition allows the Government to get the best value for the least amount.

Higher Education and Experience on Competed Contracts. Competed contracts had higher education and experience requirements for certain labor categories than the sole-source contracts. Two of the labor categories that had higher education and experience requirements on the competed contracts than on the sole-source contracts were program manager and program analyst. For example, the education and experience requirements for a program manager on the competed contract were a master's degree in engineering, chemistry, physics, mathematics, or business and a minimum of 10 years experience in program or engineering management. In contrast, the education and experience requirements on the sole-source contract were a bachelor's degree (without any mention of career field) and 10 years management experience. See Appendix D for a comparison of the education and experience requirements.

Competitive Versus Sole-Source Labor Rates. Hourly labor rates on the competitive contracts for the same or similar labor categories averaged (weighted average) about 29.9 percent less than the sole-source contracts.

Hourly labor rates in 1994 on the six sole-source indefinite-delivery, indefinite-quantity contracts were compared with similar labor categories on the five competitive contracts. Based on similar education and experience requirements in the contracts, 21 labor categories were comparable, representing $8 million of the total 1994 estimated maximum labor costs for the sole-source Section 8(a) contract costs of $13.7 million and $5 million of the 1994 estimated maximum labor costs for competitive section 8(a) contracts of $7.5 million.

Table 5 shows that the competitive hourly labor rates were significantly less than the sole-source labor rates.

Table 5. Comparison of Competitive and Sole-Source Contract Labor Rates

Labor Category	Competitive Hourly Labor Rates	Sole-Source Hourly Labor Rates	Percent Difference
Program Manager	$57.14	$83.31	31.4
Senior Engineer	47.47	55.33	14.2
Senior Systems Engineer	44.88	66.76	32.8
Senior Logistician	43.80	47.92	8.6
Senior Program Analyst	43.40	64.05	32.2
Systems Analyst	42.43	44.56	4.8
Software Engineer	40.46	78.63	48.5
Senior Analyst	38.08	54.98	30.7
Computer Systems Analyst	35.63	41.59	14.3
Logistician	33.40	35.92	7.0
Engineer	33.17	50.95	34.9
Junior Engineer	28.40	27.13	(4.7)
Program Analyst	28.11	33.64	16.4
Analyst	24.50	51.80	52.7
Technical Writer	24.01	41.54	42.2
Junior Logistician	20.77	22.73	8.6
Computer Specialist	20.19	37.43	46.1
Junior Program Analyst	19.48	36.03	45.9
Clerk Typist	19.14	25.16	23.9
Junior Analyst	19.13	33.00	42.0
Technical Typist	17.27	22.31	22.6
Weighted Average	**31.87**	**45.45**	**29.9**

From FYs 1990 through 1994, the contracts that NAVAIR funded to Section 8(a) program participants on sole-source contracts greater than $3 million averaged $27.5 million. A review of the amounts obligated on the six sole-source contracts shows that 7.12 percent of the obligated amounts represented other direct costs (including travel). Using the other direct cost factor, we calculate that about $25.5 million of the $27.5 million average sole-source contract amount represents labor costs. Therefore, if NAVAIR continues to spend about $25.5 million in labor costs each year on sole-source Section 8(a) contracts with anticipated award prices that exceed $3 million, a total of $153 million would be spent on the contracts for FYs 1996 through 2001. Using the 29.9 percent difference in labor costs on competed contracts, we calculate that NAVAIR can reduce costs by $45.7 million over the 6 years if the contracts are competed. The $45.7-million reduction in costs is based on the following assumptions: NAVAIR will continue to spend an average of $27.5 million on Section 8(a) time-and-materials contracts, other direct costs will continue to account for an average of 7.12 percent of total contract costs, and competed contracts will continue to cost an average of 29.9 percent less than sole-source contracts.

Management Comments on the Finding and Audit Response

See Appendix E for a summary of management comments on the finding and audit response on the comments.

Recommendations, Management Comments, and Audit Response

We recommend the Commander, Naval Air Systems Command:

1. Require its contracting officers and small business representative to define the anticipated award price of Section 8(a) contracts as 95 percent (or other appropriate percent based on historic funding levels) of the maximum contract value.

Management Comments. NAVAIR nonconcurred with the recommendation and stated that NAVAIR will comply with the SBA amendment to the CFR by using 100 percent of the "good faith estimate of the total value" to determine whether to compete the requirement.

Audit Response. NAVAIR comments are not responsive. Unfortunately, 100 percent of the "good faith estimate of the total value" is an arbitrary value, as were the guaranteed minimums that NAVAIR was previously using to determine anticipated contract award prices. For example, NAVAIR program managers could still have sole-source Section 8(a) contracts awarded to any contractor they choose, with maximum amounts significantly above the competitive threshold, and fund the contracts to the maximum amounts, just by setting an arbitrary "good faith estimate" below the competition threshold. We believe using historical data, such as the percentage of the maximum contract amount for which contracts were actually funded, provides a much more objective "good faith estimate." We request that NAVAIR reconsider its position and provide comments on the recommendation as part of its comments on the final report.

2. Require contracting officers to recommend competition for Section 8(a) contracts with anticipated award prices greater than $3 million.

Management Comments. NAVAIR concurred with the intent of the recommendation and stated that NAVAIR will continue to comply with the amended CFR guidance.

Audit Response. NAVAIR comments are not responsive because of its use of the "good faith estimate" as discussed in the audit response to management comments on Recommendation 1. If NAVAIR changes its position on Recommendation 1, the intent of this recommendation will be satisfied.

3. Require its small business representative to recommend to the Small Business Administration competition for Section 8(a) contracts with anticipated award prices greater than $3 million.

Management Comments. NAVAIR concurred with the intent of the recommendation and stated that NAVAIR will continue to comply with the amended CFR guidance.

Audit Response. NAVAIR comments are not responsive because of its use of the "good faith estimate" as discussed in the audit response to management comments on Recommendation 1. If NAVAIR changes its position on Recommendation 1, the intent of this recommendation will be satisfied.

4. Fully implement a management control program and ensure that management perform scheduled reviews of assessable units.

Management Comments. NAVAIR concurred with the recommendation and stated that the management control program will be fully implemented once the office has sufficient staff. Estimated completion date is July 30, 1996.

Audit Response. NAVAIR comments are responsive. However, we remain concerned that NAVAIR has placed insufficient emphasis on its management control program. NAVAIR failed to complete any scheduled reviews of assessable units in FYs 1993, 1994, and 1995, including those assessable units that NAVAIR determined were "high risk." Now the failure by NAVAIR to plan to complete any of the reviews in FY 1996 is disappointing.

Management Comments on the Potential Monetary Benefits and Audit Response

Management Comments. NAVAIR nonconcurred with the monetary benefits because the amendment to the CFR was in effect before the draft report and NAVAIR has been in compliance with the recommendation.

Audit Response. As discussed in the audit response to Recommendation 1, NAVAIR will not realize any monetary benefits by using the "good faith estimate of the total value" to determine whether the anticipated contract value exceeds the competitive threshold. NAVAIR program managers will still be able to select the contractors they prefer on a sole-source basis without the benefits of competition and fund contracts with those contractors at values that greatly exceed the competitive threshold, just by using a good faith estimate below the competitive threshold. Monetary benefits will result through the use of historic data on the percentage of the maximum contract amount for which contracts are actually funded because more contracts with actual values greater than $3 million will be competed. We request that NAVAIR reconsider its position on the monetary benefits and provide comments on the recommendation as part of its comments on the final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We reviewed amounts obligated on Section 8(a) time-and-materials indefinite-delivery, indefinite-quantity contracts for FYs 1990 through 1995. We reviewed Section 8(a) indefinite-delivery, indefinite-quantity contracts that exceeded $3 million that SBA awarded for NAVAIR between June 1993 and June 1994.

Methodology

Review of NAVAIR Section 8(a) Contracts. For the 11 Section 8(a) contracts greater than $3 million that SBA awarded for NAVAIR, we compared labor rates and the education and experience requirements for each comparable labor category on the sole-source and competitive contracts. We interviewed the contracting officers, program managers, and small business representative. In addition, we reviewed the management control program at NAVAIR.

Use of Computer-Processed Data. We relied on computer-processed data generated by the DD350 system to compile a list of all Section 8(a) indefinite-delivery, indefinite-quantity contracts that NAVAIR funded from 1990 through 1994. Although we did not perform a reliability assessment of the computer-processed data, we determined that the total contract values, award dates, and contractors on the contracts reviewed generally agreed with the information in the computer-processed data. We did not find errors that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusion in the report.

Audit Period, Standards, and Locations. We performed this program audit from February through August 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. No statistical sampling procedures were used during the audit. Appendix F lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the management control procedures at NAVAIR. We also reviewed the adequacy of management controls over sole-source Section 8(a) contracts with anticipated award prices greater than $3 million. Specifically, we reviewed the management control plan to determine whether management control reviews were performed. We also reviewed the vulnerability assessments that rated each of the program assessable units.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38. The NAVAIR management control program had not been fully implemented in that scheduled reviews of assessable units were not performed. Consequently, management controls were not adequate to ensure that Section 8(a) contracts with anticipated award prices that exceeded $3 million were recommended for competition. Recommendations 1., 2., 3., and 4., if implemented, will improve the management control program at NAVAIR and could result in potential monetary benefits of $45.7 million (Appendix E). A copy of the report will be provided to the senior official responsible for management controls in the Office of the Chief of Naval Operations.

Adequacy of Management's Self-Evaluation. In December 1992, NAVAIR identified 82 assessable units covering 15 major program areas. NAVAIR identified competitive and sole-source procurements as an assessable unit with a medium risk ranking. During FYs 1993, 1994, and 1995, NAVAIR scheduled 40 reviews of the assessable units (11 assessable units were designated as high risk), but none of the reviews were conducted.

Appendix B. Summary of Prior Audits and Other Reviews

General Accounting Office

General Accounting Office Report No. GAO/RCED-94-28 (OSD Case No. GAO/RCED-94-28), "Energy Management: Department of Energy Can Improve Distribution of Dollars Awarded Under SBA's 8(a) Program," February 23, 1994, states that the Department of Energy avoided the competition requirement directed by the Small Business Act to award Section 8(a) contracts sole source to a select number of contractors. Program offices structured procurements to understate the actual costs of obtaining contractor services. The Department of Energy awarded 58 percent of the $1 billion worth of active contracts to 13 contractors. The remaining 42 percent was allotted among 112 contractors.

The report recommended that the Department of Energy direct program offices at headquarters not to structure Section 8(a) contracts to avoid competition thresholds established in the Business Opportunity Development Reform Act. The response by the Department of Energy indicated that it would evaluate the recommendation as part of its reform effort and would review the impact that the current contract award practices have on competition.

Inspector General, DoD

Report No. 93-051. Inspector General, DoD, Report No. 93-051, "Contract Award Protest of a Small Business Administration 8(a) Contractor," February 4, 1993, states that the U.S. Army Information Systems Selection and Acquisition Agency did not adequately comply with the requirements related to the Walsh-Healey Public Contracts Act and other small business 8(a) contracting requirements for the Installation Transition Processing program. Specifically, the contracting officer did not determine Walsh-Healey Act compliance. Further, competition was not pursued and proposals were not adequate to ensure that small business requirements were met.

Because the procurement was withdrawn, no recommendations were made. Although not required, the Army Information Systems Selection and Acquisition Agency elected to comment, stating that it acted appropriately and in accordance with the applicable rules in its Installation Transition Processing acquisition.

Report No. 93-024. Inspector General, DoD, Report No. 93-024, "The Use of Small Business Administration Section 8(a) Contractors in Automatic Data Processing Acquisitions," November 25, 1992, states that DoD Components were not following specific guidance for the effective use of the Section 8(a)

Program. The Navy did not take full advantage of the opportunity to compete (offer for competitive bids) automatic data processing acquisition under the Reform Act. The report identifies six Navy Section 8(a) contracts that had exceeded competition thresholds but were sole-source acquisitions. Five of the six contracts were not competed because of a loophole in the regulations.

The report cites two recommendations. One was made to the Director, Office of Small and Disadvantaged Business Utilization, requesting that the small business administration regulatory language in 13 CFR 124.311(a)(2) be changed from "the guaranteed minimum value of the contract" to "the estimated total lifetime value of the contract." The other recommendation was made to the Director, Defense Procurement, requesting that the Defense Acquisition Regulatory Council change the Defense Federal Acquisition Regulation Supplement to require that contracting officers justify in the "Agency Offering" why a proposed procurement that exceeds the dollar thresholds cannot be competed under the Business Opportunity Development Reform Act of 1988. As a result of mediation, the Director, Defense Procurement, issued a memorandum instructing contracting officers to pay close attention to the use of indefinite-delivery, indefinite-quantity type contracts for Section 8(a) procurements and to ensure that the use of that contract type is appropriate and the contract type is not used to circumvent competition requirements.

Appendix C. Complaint to the Defense Hotline

Background. The Defense Hotline received a complaint concerning a support services subcontractor who was using his influence to obtain work on a sole-source basis. We were asked to determine whether the contract award process that was followed in the award of the questioned contract was conducted in accordance with established procurement regulations.

Allegation. Work was improperly assigned to a specific contractor on a sole-source basis.

Audit Results. The complaint could not be substantiated. We could not determine whether the contractor, actually a subcontractor, improperly influenced the decision to select the Section 8(a) prime contractor who was awarded the contract. We did find, however, that NAVAIR inappropriately recommended that SBA award on a sole-source basis Section 8(a) indefinite-delivery, indefinite-quantity contracts with anticipated award prices that exceeded $3 million.

Appendix D. Comparison of Education and Experience Requirements on Competitive and Sole-Source Section 8(a) Contracts

Competitive contracts had higher or equal education and experience requirements than sole-source contracts for labor categories compared. Program manager and program analyst positions are two examples of the labor categories with higher education and experience requirements on the competitive contracts as compared with the sole-source contracts.

Competitive Contract	Sole-Source Contract
Program Manager Education	Program Manager Education
Master's degree from an accredited college or university in engineering, chemistry, physics, mathematics, or business.	Bachelor's degree from an accredited college or university.
Program Manager Experience	Program Manager Experience
Minimum of 10 years experience in program or engineering management relative to fighter/attack/helicopter aircraft weapons systems and a detailed understanding of Defense systems acquisition management.	Minimum of 10 years management experience with 5 years experience in DoD project management/project management support and/or project coordination and 4 years supervisory experience.
Program Analyst Education	Program Analyst Education
Bachelor's degree from an accredited college or university.	Minimum of 2 years of college education.
Program Analyst Experience	Program Analyst Experience
Minimum of 6 years experience in program analysis of Defense systems, production scheduling, configuration management, statistics, or data analysis. Demonstrated experience in four or more of the following: data base development, DoD systems procurement strategies, use of management information systems, integrated logistics support, configuration management, computer systems analysis, or production/ manufacturing analysis.	Minimum of 2 years DoD experience in analyzing ordnance/armament systems acquisition and production programs. Experience in collection, compilation, organization, and interpretation of technical and financial information, preferably related to ordnance or armament acquisition or production engineering programs; specialized techniques for data reduction; use of management information systems; and preparation of graphics.

Appendix E. Summarized Management Comments and Audit Response

Management Comments on the Finding

Management Comments on Compliance with the Regulations. NAVAIR commented that at the time these contracts were awarded, the CFR defined "anticipated award price" for the purposes of indefinite-delivery, indefinite-quantity contracts as the "guaranteed minimum value." Therefore, NAVAIR was in compliance with the regulation when the minimums guaranteed by NAVAIR represented from 10 to 50 percent of the maximum contract amount. Those guaranteed minimums were more than nominal amounts as required by the FAR. Further, NAVAIR would require special authorization from the SBA to compete contracts below the threshold requirements.

Audit Response. The SBA eliminated the "guaranteed minimum value" as the threshold for competition because of the wide differences commonly occurring between the "guaranteed minimum" amounts and the amounts actually expended under the procurements. We do not believe it was a coincidence that the "guaranteed minimums" used by NAVAIR ranged from 10 to 50 percent, depending on the maximum contract amount. Further, the "guaranteed minimum" percentages used by NAVAIR represented the same percentages needed to keep the procurements below the competition threshold.

Management Comments on Appropriateness of Sole-Source Award. NAVAIR commented that the audit report provides no evidence to support the allegation that the sole-source awards were made inappropriately or that contracting officers and the small business representative used the "guaranteed minimum value" rule to avoid competition. In addition, the law provides that Section 8(a) competitions require the expectation that at least two eligible program participants will compete for the requirement and that award can be made at fair market price. NAVAIR stated that five of the six sole-source contracts were awarded to the incumbent contractor and that there was no reason to assume that meaningful competition was available.

Audit Response. The SBA eliminated the "guaranteed minimum value" rule because of exactly what NAVAIR was doing, using arbitrary percentages of the maximum contract amount to establish a minimum contract amount that was just below the regulatory competition threshold. The SBA stated that the old rule implicitly required a good faith estimate by the contracting agency of the anticipated contract award price. As for the issue of meaningful competition, we reviewed the competitive and sole-source contract statements of work and labor category descriptions and found no evidence that multiple Section 8(a) program participants could not perform the tasks.

Management Comments on Revised CFR Threshold. NAVAIR commented that it has been in compliance with the revised CFR threshold for indefinite-delivery, indefinite quantity contracts since the CFR was amended on August 7, 1995.

Audit Response. Although the new CFR rule on competition explicitly requires that the anticipated award price be based on a "good faith estimate," we believe the "good faith estimate" will be no different than "guaranteed minimum value" and will be used to circumvent competition. A far better estimate of the anticipate award price would be a percentage of the maximum contract award amount based on prior experience.

Specific Comments by Management

Management Comments on SBA Competing Contracts. NAVAIR commented that NAVAIR conducts the actual competition and that SBA makes the determination on whether or not to compete the contract.

Audit Response. We recognize that NAVAIR conducts the actual competition and have revised the sentence for clarification.

Management Comments on Estimated Maximum Labor Costs. NAVAIR commented that the report implied that "estimated maximum labor costs" is synonymous with "anticipated contract value." NAVAIR complied with CFR guidance, which defined "anticipated contract price" as the "guaranteed minimum value" for the purposed of indefinite-delivery, indefinite quantity contracts.

Audit Response. SBA stated that a good faith estimate of the anticipated contract price was implicit in the old CFR guidance. Our review showed that the estimated maximum contract labor costs represented a significantly closer estimate of the anticipated contact price than the arbitrary minimum contract values used by NAVAIR.

Management Comments Table 2. NAVAIR commented that Table 2 indicated that contracts N00019-93-D-0184 and N00019-94-D-0060 were section 8(a) competitive awards, while NAVAIR records indicate the awards were not competitive, but were small business set-asides.

Audit Response. The records show that the awards were section 8(a) competitive. The business clearance memorandum for contract N00019-93-D-0184 states that the solicitation was mailed to 344 potential offerers and that 8 offers were received. The offers were reviewed, and the award was made to the contractor whose proposal proved the most advantageous to the Government, price and other factors considered. NAVAIR may be confused with the way section 8(a) procurements are coded in the DD-350 data base. Section 8(a) procurements that are awarded on a sole-source basis are coded as

other than full and open competition, while section 8(a) procurements that are competed among eligible program participants are coded section 8(a) set-asides.

Management Comments on Using the Guaranteed Minimum Value Rule to Avoid Competition. NAVAIR commented that the finding alleges that NAVAIR contracting officers and the SBA representative used the guaranteed minimum value rule to avoid competition.

Audit Response. NAVAIR contracting officers and the SBA representative used the guaranteed minimum value rule to avoid obtaining competition. Otherwise, they would have had to compete the procurements because the actual value of each contract significantly exceeded the threshold for competition.

Management Comments on Maximum Contract Amounts. NAVAIR commented that the use of maximum contract amount in the finding implies that the requirements were known and certain prior to contract award. However, indefinite-delivery, indefinite-quantity contract were used because requirements, other than the guaranteed minimums, were uncertain.

Audit Response. We disagree that the guaranteed minimums represented the known NAVAIR requirements. As shown in Table 4, the amounts obligated on each contract were significantly closer to the maximum contract amounts than the minimum contract values.

Management Comments on Funding Contracts at 91 Percent of the Maximum Contract Amount. NAVAIR commented that the statement that contracts were funded at 91 percent of the maximum contract amount was misleading because the footnotes at the end of the Table 4 were incomplete and because the data for one contract was incorrect.

Audit Response. We corrected the data in Table 4; however, the data still shows that the contracts were funded at 91 percent of the maximum contract amounts for the base year. In addition, four of the six contracts were funded at 100 percent or greater than the maximum contract amount for the base year.

Management Comments on Use of Guaranteed Minimum to Avoid Competition. NAVAIR commented that they did not use the guaranteed minimum to avoid competition.

Audit Response. As previously stated, NAVAIR awarded sole-source Section 8(a) contracts that were funded for amounts significantly higher than the thresholds requiring competition and used the minimum guaranteed value rule to avoid competition.

Management Comments on Four of Six Contracts. NAVAIR commented that the maximum amounts were not ordered on two of the contracts and, therefore, the report should read four of the six contracts.

Audit Response. Based on management comments, we revised the paragraph.

Management Comments on Comparison of Labor Categories and Rates. NAVAIR commented that there is no evidence that the labor categories or place of performance were actually comparable between contracts selected. In addition, NAVAIR was unclear whether the competitive and sole-source rates shown for each category were averages from various contracts or whether the individual rates were picked from more than one contract.

Audit Response. The labor category descriptions were easily compared because they were included in the contracts and identified experience and educational requirements. The place of performance was primarily NAVAIR. The labor rate comparisons represent the averages for all labor hours and costs for comparable labor categories.

Management Comments on Expected Monetary Benefit

NAVAIR did not concur with the potential monetary benefits identified. It stated that the recommendations were based on findings identified prior to the change in the regulation and NAVAIR is in compliance with the current regulation. We maintain that unless NAVAIR uses an anticipated contract award price that represents an accurate value at which contracts will be funded, contracts in excess of $3 million will not be competed and the Government will not realize the financial and qualitative benefits of competition identified in this report.

Appendix F. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
1., 2., 3.	Management Controls. Obtains competition on Section 8(a) contracts with anticipated award prices greater than $3 million.	Funds put to a better use of $45.7 million in various Navy appropriations.
4.	Management Controls. Improves the management control program at NAVAIR.	Nonmonetary.

Appendix G. Organizations Visited or Contacted

Departments of the Navy

Naval Air Systems Command, Arlington, VA

Other Defense Organizations

Defense Criminal Investigative Service, Arlington, VA
Small Business Administration, Washington, DC

Appendix H. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Director, Defense Procurement
Director, Small and Disadvantaged Business Utilization
Assistant to the Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency

Non-Defense Federal Organizations

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

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 Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House 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

Naval Air Systems Command Comments

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

DEC 14 1995

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DRAFT REPORT ON THE AUDIT OF A COMPLAINT TO THE DEFENSE HOTLINE ON SOLE-SOURCE SECTION 8(a) CONTRACTS AT THE NAVAL AIR SYSTEMS COMMAND (PROJECT 5CF-7002)

Ref: (a) DODIG Memo of 22 Sep 95

Encl: (1) DoN Response to Draft Audit Report

I am responding to the draft audit report forwarded by reference (a) concerning sole-source Section 8(a) contracts at the Naval Air Systems Command.

The Department of the Navy response is provided at enclosure (1). We do not concur with the finding of the report. The Department of the Navy acted in compliance with existing regulatory requirements for Section 8(a) competitions, and we are currently in compliance with the regulatory revisions. As such, we concur with the intent of Recommendations 2 and 3 to compete Section 8(a) contracts consistent with current regulation. We do not concur with Recommendation 1 to impose a competition thresholds unique to the Naval Air Systems Command. We do concur with Recommendation 4 concerning the implementation of the Management Control Program. Our detailed response is provided as enclosure (1).

Robert V. Johnson
Principal Civilian Deputy

Copy to:
NAVINSGEN
FMO-132
COMNAVAIRSYSCOM (AIR-8.0G)

DEPARTMENT OF THE NAVY RESPONSE

TO

DODIG DRAFT REPORT OF SEPTEMBER 22, 1995

ON

COMPLAINT TO THE DEFENSE HOTLINE ON
SOLE-SOURCE SECTION 8(A) CONTRACTS AT THE NAVAL AIR SYSTEMS COMMAND
(PROJECT NO. 5CF-7002)

FINDING:

NAVAIR inappropriately recommended to SBA the sole-source award of six Section 8(a) indefinite-delivery, indefinite quantity contracts, each with an anticipated award price greater than $3 million. Sole-source Section 8(a) contracts were not competed because NAVAIR contracting officers and the small business representative either used the Small Business "guaranteed minimum value" rule to allow them to avoid competition, or believed that the anticipated contract award price was the guarantee minimum contract amount. NAVAIR also had not fully implemented an effective management control program. As a result, NAVAIR paid about 30 percent more for labor costs on sole-source Section 8(a) contracts than it would have paid if the work had been competed among Section 8(a) participants. In addition, labor categories on the competed contracts had higher education and experience requirements than the sole-source contracts. NAVAIR could reduce costs by about $45.7 million over 6 years if Section 8(a) contracts with anticipated award prices that exceeded $3 million were competed.

DON Position: Do not concur for two reasons.

1. NAVAIR complied with the regulations in place at the time of award. At the time these contracts were awarded, the Code of Federal Regulations (CFR) defined "anticipated award price" for the purposes of indefinite-delivery, indefinite-quantity contracts as the "guaranteed minimum value". In compliance with the CFR, NAVAIR used the "guaranteed minimum value" to determine the Section 8(a) competition threshold. As noted in the audit report, the minimums guaranteed by NAVAIR represented from 10 to 50 percent of the maximum contract amount so they were in compliance with Federal acquisition requirements that guaranteed minimums be more than a nominal amount. For NAVAIR to compete below threshold requirements, the CFR provides that NAVAIR must first obtain specific authorization from the Associate Administrator for Minority Small Business and Capital Ownership Development, and that such approvals would be granted on a limited basis and take into consideration whether the

ENCLOSURE(1)

requesting agency will continue to make available a significant number of non-competitive Section 8(a) awards.

2. The audit report provides no evidence to support the allegation that the sole-source awards were made inappropriately, or that contracting officers and the small business representative used a "guaranteed minimum value" rule to avoid competition. In addition to dollar value, the law provides that Section 8(a) competitions require the expectation that at least two eligible Program Participants will compete for the requirement and that award can be made at a fair market price. It is noted that five of the six sole-source contracts were awarded to the incumbent contractor. It is clearly in error to assume that contracts of a certain dollar value should be competed without considering whether meaningful competition is available.

NAVAIR has been in compliance with the revised CFR threshold for indefinite-delivery, indefinite quantity contracts since its effective date of 7 August 1995.

RECOMMENDATIONS:

We recommend the Commander, Naval Air Systems Command:

1. Require contracting officers and the small business representative to define the anticipated award price of Section 8(a) contracts as 95 percent (or other appropriate percent based on historic funding levels) of the maximum contract value.

DON Position: Do not concur. NAVAIR is complying with the 7 August 1995 SBA amendment to the Code of Federal Regulation 13 CFR 124.311(a)(2), and accordingly, is using 100% of the "good faith estimate of the total value" to determine whether to compete the requirement. The recommendation differs from the regulatory guidance provided in this amendment and should be deleted.

2. Require contracting officers to recommend competition for Section 8(a) contracts with anticipated award prices greater than $3 million.

DON Position: Concur with the intent of the recommendation. NAVAIR will continue to comply with the regulatory change provided in the 7 August 1995 amendment to 13 CFR 124.311(a)(2).

3. Require the small business representative to recommend to the Small Business Administration competition for Section 8(a) contracts with anticipated award prices greater than $3 million.

DON Position: Concur with the intent of the recommendation. We will continue to comply with the regulatory change provided in the 7 August 1995 amendment to 13 CFR 124.311(a)(2).

Final Report Reference

4. Fully implement a management control program and ensure that management perform scheduled reviews of assessable units.

DON Position: Concur. The Management Control Program will be fully implemented once the office has sufficient staff. Estimated completion date is 30 July 1996.

Expected Monetary Benefit: Nonconcur. The audit assumes that future savings can be obtained by accepting the audit recommendation. The change in regulation was in effect before the draft audit was received by NAVAIR. NAVAIR has been in compliance with the regulations as changed.

DON Specific Comments

Page 5, Para. 1, Line 5. On line 5, reference is made to the SBA competing contracts. Please note that NAVAIR conducts the actual competition, SBA makes the determination on whether to compete or not. — Page 3 Revised

Page 5, Para. 2, Line 1. It is implied that "estimated maximum labor costs" is synonymous with "anticipated contract value." NAVAIR complied with the Code of Federal Regulations (13 CFR 124.311) which defined "anticipated award price" as the "guaranteed minimum value" for the purposes of ID/IQ contracts at the time these contracts were awarded. — Page 3

Page 5, Table 2. Table 2 indicates that contracts N00019-93-D-0184 and N00019-94-D-0060 were 8(a) competitive awards. Our records indicate that they were small business set-asides awarded to small disadvantaged businesses then currently enrolled in the 8(a) program. They were not 8(a) competitions. — Page 3

Page 7, Para 1, Line 3. Delete the second sentence. It is worded in such a manner as to provide a false impression regarding NAVAIR contracting officers and the NAVAIR SBA Representative. It also makes an allegation (using the guaranteed minimum value to avoid competition) that is not true. The sentence gives the impression that NAVAIR contracting officers conspired to violate the $3 million rule by seizing on a technicality and, therefore, were not "playing by the rules." NAVAIR did not "use" the guaranteed minimum value to avoid competition. — Page 5

Page 9, Para. 2, Line 5. The sentence beginning "The maximum contract..." is not correct. The sentence implies that the requirements were known and certain prior to award, but that is not true. An ID/IQ contract was used because the requirements, other than the guaranteed minimum, were uncertain. — Page 6

Page 9, Para. 2, Line 6. The audit states, "We determined that the sole-source contracts were funded at 91 percent of the maximum contract amount..." This statement is misleading because — Page 6

Final Report Reference

omissions in footnotes one and two to Table 4, if corrected, would have an impact on the calculation. The two footnotes to Table 4 are incomplete. Note 1 should read, "Obligated amounts include travel and other direct costs, which average a combined 7% of labor costs." Note 2 should read, "The base year of contract N00019-94-D-0203 was bilaterally extended six months to January 1996 (18 month base period) due to the program office's inability to meet the minimum contract guarantee (50%) within the original 12 month base period." Additionally, correct the Table 4 chart for contract N00019-94-D-0129 as follows:

Revised

Revised

* Change the "Contract Years" from "2" to "3"
* Change the "Total Contract Amount" - Max. from "$6.0" to "$8.0" - Min from "$0.6" to "$0.9."
* The "Base Year Contract Amount" figures remain unchanged.
* Revise "Total" figures as required.

Page 7

Page 10, Para. 1, Line 4. Delete or modify the second sentence as it is not true. NAVAIR did not use the guaranteed minimum to "avoid competition."

Page 8 Revised

Page 10, Para. 1, Line 4. Change the beginning of sentence six from "For each of the six..." to "For four of the six...." The chart on page 9, under "Base Year Contract Amount," shows that the last two contracts never ordered the maximum amounts.

Page 9

Page 12, Table 5. There is no evidence that the labor categories or place of performance are actually comparable between the contracts selected. Also, it is unclear whether the competitive and sole-source rates shown for each category are averages from various contracts or whether the individual rates are picked from one or more contracts.

Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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