

United States General Accounting Office

GAO

Report to the Chairman, Committee on
Governmental Affairs, U.S. Senate

AD-A251 553



May 1992

CONTRACT PRICING

DCAA's Audit Coverage Lowered by Lack of Subcontract Information



**BEST
AVAILABLE COPY**

92-15317



**United States
General Accounting Office
Washington, D.C. 20548**

**National Security and
International Affairs Division**

B-242859

May 29, 1992

The Honorable John Glenn
Chairman, Committee on Governmental Affairs
United States Senate



Accession For	
NTIS GRA&I	<input checked="" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By _____	
Distribution/	
Availability Codes	
Dist	Avail and/or Special
A-1	

Dear Mr. Chairman:

This report is one in a series being issued in response to your request that we evaluate the adequacy of controls for preventing fraud, waste, and mismanagement in Department of Defense (DOD) subcontract pricing. Audits by the Defense Contract Audit Agency (DCAA) are one of DOD's key controls for determining whether the government was overcharged because a subcontract was "defectively priced."¹ In the past, these audits have disclosed widespread subcontract defective pricing. DCAA's policy is to identify and assess the defective pricing risk of all subcontracts subject to an audit under federal law and then allocate resources commensurate with those risks. Our objective in this report was to determine to what extent DCAA is aware of subcontracts subject to defective pricing audits.

We selected 211 negotiated subcontracts that were contained in four major DOD prime contracts—two from the Air Force, and one each from the Army and Navy—to determine the extent to which DCAA is aware of these subcontracts. The prime contracts were chosen to provide a sample that covered the three services. The four prime contracts had a total value of \$1.1 billion. Collectively, the inventory of 211 subcontracts had a dollar value of about \$337 million and represented subcontractors located in 54 of the 152 DCAA field offices. We sent questionnaires to, or visited, each of the field offices responsible for the subcontracts in our sample to determine whether the subcontract was included in their inventory of subcontracts subject to a defective pricing audit.

¹Defective pricing occurs when a contractor or subcontractor negotiating a price for a noncompetitive contract or subcontract, respectively, does not submit accurate, complete or current data about the costs included in its proposal and, as a result, the contract price is increased. If defective pricing is found, the government has a right to recover the amount of the increase.

Results in Brief

DCAA was not aware of 186, or 88 percent, of the 211 subcontracts in our sample. In a few cases, the responsible field office did not know of any of the subcontractor's contracts or even that the subcontractor was located in the office's jurisdiction. The 186 unknown subcontracts, which totaled about \$189 million, represented over half the value of the subcontracts in our sample.

The smaller the subcontract, the less likely that DCAA was aware of it. DCAA had no knowledge of about 90 percent of the subcontracts that were less than \$10 million, and no knowledge of one-third of the subcontracts that were \$10 million or more.

Two causes contribute to DCAA's lack of awareness of so many subcontracts. First, the data DCAA currently uses to develop its subcontract inventory is incomplete. Second, when field offices become aware of subcontracts during their audits of prime contracts, they do not routinely pass this information to the field offices with responsibility for the subcontracts.

Being unaware of so many subcontracts increases the government's vulnerability to subcontract defective pricing, because DCAA cannot ensure that its audit resources are applied to subcontracts having the greatest risk of defective pricing. Lack of awareness of so many subcontracts also understates the number of audits and amount of staff resources necessary to reduce DOD's risk of defective pricing.

Background

Subcontract costs have grown as many prime contractors have shifted from fabricating weapons and products to integrating work done by subcontractors. Active DOD subcontracts totaled \$193 billion as of the end of fiscal year 1990. Because many weapon systems are complex one-of-a-kind products, DOD often cannot rely on competitive market forces and must instead award contracts noncompetitively, using extensive negotiations.

Recognizing the government's vulnerability to inflated contract prices in noncompetitive contracting situations, the Congress in 1962 passed the Truth in Negotiations Act (P.L. 87-653, codified at 10 U.S.C. 2306a). The act is intended to protect against inflated contract prices by requiring contractors and subcontractors to submit cost or pricing data supporting their proposed prices and to certify that the data submitted is accurate, complete, and current. The act requires certification on contracts or

subcontracts of \$500,000 or more.² When the act is applicable, the government has a right to obtain a price reduction from the prime contractor if it is determined that the prime contractor's price was overstated because the data submitted by either the prime or subcontractor were not in accordance with the statute and the certification. The prime contractor, in turn, usually has a contractual right to obtain a reduction for any defective pricing caused by a subcontractor.

We have reported that DCAA's audits disclosed significant subcontract defective pricing.³ In fiscal years 1987-91, subcontract defective pricing accounted for 37.1 percent of the defective pricing DCAA reported. Subcontract defective pricing totaled about \$1.36 billion—an average of about \$1.3 million for each overpriced subcontract. In addition, defective pricing was as common in small subcontracts under \$10 million as it was in larger subcontracts. Defectively priced smaller subcontracts had, as a percentage of subcontract value, more defective pricing than did larger subcontracts. We have found that, of the subcontracts that were defectively priced, the percentage of defective pricing increased as the size of the subcontract decreased, rising to 24 percent of value for subcontracts valued at \$500,000 or less.

Identification of contracts and subcontracts subject to defective pricing audits is decentralized among DCAA's 152 field offices. Each field office is responsible for a particular location (such as a major defense contractor) or for a geographic area that may include many contractors. Each year, the field office must develop an inventory of contracts and subcontracts for its location or area. DCAA guidance states that a complete inventory would include all negotiated prime contracts and subcontracts for which the government requires cost or pricing data. Contracts and subcontracts are included in the inventory for 3 years after the award year.

Using the inventory it assembles, each field office assesses the risks associated with each contractor, considering factors such as the adequacy of the contractor's estimating and accounting systems, past incidents of defective pricing, and contract value and type. It then determines the number of audits required to provide adequate coverage of contracts and subcontracts in the defective pricing inventory. For example, for

²Between April 1985 and December 1990, the Truth in Negotiations Act generally required certified cost or pricing data for negotiated contracts of \$100,000 or more.

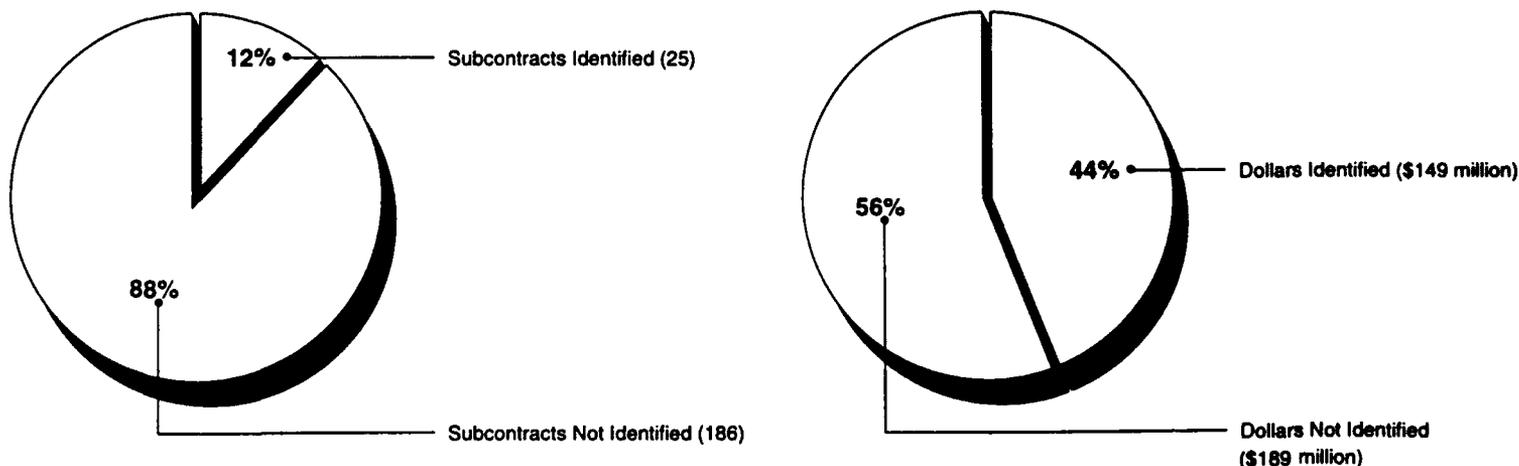
³Contract Pricing: Status of Defective Pricing (GAO/NSIAD-92-184FS).

fixed-priced contracts and subcontracts with a high risk of defective pricing, DCAA's fiscal year 1991 guidance required audits of all contracts of \$10 million or more, but only 1 of 10 between \$1 million and \$10 million, and only 1 of 50 under \$1 million. (See app. I.) On the basis of these audit requirements, DCAA headquarters allocates resources to field offices for conducting defective pricing audits. Field offices then select contracts to audit.

DCAA Was Unaware of Most Subcontracts Subject to Defective Pricing Audits

As shown in figure 1, the 186 subcontracts that DCAA was unaware of in our sample of 211 represented over half the value—\$189 million—of our sample.

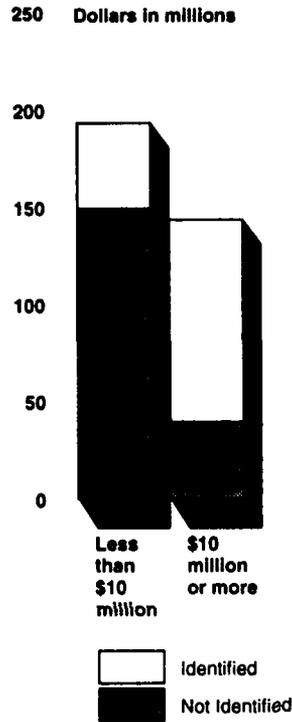
Figure 1: Subcontracts and Their Dollar Value



Field Offices Were Less Aware of Smaller Subcontracts

Field offices had less knowledge of the smaller subcontracts than the larger ones. They were unaware of 184 of the 205 subcontracts with values less than \$10 million and 2 of the 6 subcontracts with values of \$10 million or more. In terms of contract value, field offices were not aware of \$149.3 million (77 percent) of the dollars in subcontracts under \$10 million and \$39.2 million (27 percent) of the dollars in subcontracts of \$10 million or more. (See fig. 2.)

Figure 2: Dollar Value of Large and Small Subcontracts



Field Offices Unaware of Subcontractors' Existence

In a few cases, the cognizant field office did not know of a subcontractor's contracts or was not aware subcontractors even existed. For example, in responding to our questionnaire, one field official told us that his office was unaware of two subcontractors in the area his office served. These contractors had four subcontracts, totaling over \$9 million, that were subject to defective pricing audits. The following are additional examples of subcontracts the field offices were not aware of:

- One field office had no knowledge of three subcontracts worth \$39.7 million to produce fuel management system parts for engines on the Army's M-1 tank. Two of the three subcontracts were over \$10 million and according to DCAA guidance, required an audit.
- Another field office reported that it had no knowledge of one subcontractor's 13 subcontracts costing \$3.4 million, under a prime contract for missile equipment.

Reasons Why DCAA Is Not Aware of Subcontracts

In our discussions with the field offices responsible for the subcontracts, DCAA officials provided reasons why they were unable to identify more of the subcontracts in our sample.

The Recommended Data Sources Do Not Identify All Subcontracts

DCAA guidance to its field offices provides a list of four possible sources of information to use in developing an inventory: listings obtained from contractors in their immediate geographic area, proposal audits DCAA has conducted,⁴ DOD Contract Administration Reports, and annual overhead claim letters. DCAA offices have no comprehensive information source that identifies all subcontracts subject to defective pricing. In addition, the Federal Acquisition Regulation does not require contractors to report information on all subcontracts subject to the act to DOD. None of the recommended sources provide complete information, and the sources often identify contracts differently. We found that field offices depend primarily on two of the sources: lists they maintain locally of contract proposals they have audited and lists obtained from local contractors.

Each of the two primary sources used also has its own set of problems. First, the field office lists of their contract proposal audits are often incomplete in that they generally exclude subcontract proposals audited by the prime contractor and those contracts—primarily small ones—on which the contracting officer waives the audit. Second, the contract proposals may not identify what was actually awarded or the contractor that actually received the subcontract.

DCAA has stated that contractor listings, the other principle source, are the best information available. However, DCAA officials told us that some contractors do not respond to field office requests for information and that contractors are not required to respond. In addition, at five of the six field offices we asked, DCAA officials said they develop their inventories by obtaining listings from a limited number of the contractors in their geographic areas—primarily the major contractors they are most familiar with and who generally have substantial government business. Further, DCAA officials noted that contractors' listings sometimes include erroneous information such as competitively awarded subcontracts that are not subject to the act.

⁴DOD regulations require prime contractors to conduct a cost analysis of certain subcontractor proposals. However, under a variety of circumstances, DOD may request DCAA to analyze the costs.

Field Offices Do Not Share Subcontract Information

Field offices auditing prime contractors frequently obtain information that would help other field offices develop a more complete inventory of subcontracts subject to defective pricing audits. DCAA does not require field offices to exchange this information and, at the time of our review, only one of the three resident offices responsible for the four prime contracts we used to develop our sample routinely shared this information.

All of the subcontracts in our sample are under field offices other than the three responsible for the four prime contracts we used to develop the sample. The three field offices are resident offices that are each responsible for a single major contractor. The subcontracts awarded by that prime contractor would be outside the auditing field office's jurisdiction and therefore are under the cognizance of different DCAA field offices. We do not consider this situation to be unusual because in 1991, 60 of DCAA's 152 field audit offices were resident offices.

At the one resident office that shared information, the official we talked to routinely notified other offices of subcontracts that should be included in their defective pricing inventories. At that resident office, the prime contractor, although not required to, did cooperate with DCAA by providing listings of subcontracts awarded under the prime contract. The resident office official said that, with the prime contractor's cooperation, notifying other field offices of subcontracts in their area was not difficult.

At the time of our review, officials at the other two resident offices told us they did not routinely share subcontract information with other field offices. Subsequently, we were told that one of these offices is starting to provide this information.

Subcontracts Unknown to DCAA Increase the Government's Vulnerability to Defective Pricing

Because DCAA is unable to develop a complete list of subcontracts subject to defective pricing audits, the government is at greater risk that defective pricing will go undetected. This risk has two primary components.

DCAA May Be Missing Risky Subcontracts

Field offices cannot consider auditing subcontracts they do not know about and may miss auditing subcontracts having a significant defective pricing risk. For example, DCAA considered all six of the subcontracts over \$10 million in our sample to have sufficient risk to require defective pricing audits. Field offices audited the four subcontracts they were aware of, but could not audit or assess the risk of defective pricing in the two unknown subcontracts. DCAA's defective pricing program manager told us that incomplete inventories causing limited audit coverage are of concern because field offices may not be auditing subcontracts having the greatest potential for defective pricing.

Some of the unidentified subcontracts under \$10 million in our sample also may have considerable risk of defective pricing. Our previous work shows that smaller subcontracts had, as a percentage of subcontract value, more defective pricing than did large subcontracts. In fiscal years 1987-91, for subcontracts valued between \$500,000 and \$1 million, when DCAA found defective pricing it equaled 16.2 percent of the subcontract value. Therefore, the smaller subcontracts DCAA missed may have included significant defective pricing risk. Because DCAA's audit procedures require auditing a sample of contracts under \$10 million, we could not determine how many of the unidentified subcontracts DCAA would have audited if the subcontracts had been known. However, until DCAA becomes aware of the subcontracts and assesses the defective pricing risk, it cannot ensure that its audit resources are being applied where the risks are the greatest.

DCAA Audit Resources Requirements Understated and Resources May Be Misdirected

When DCAA is not aware of all subcontracts, it will understate resources required for defective pricing audits and will have an incomplete basis for distributing those resources among field offices. DCAA determines its defective pricing work load by relying on each field office to accurately identify its audit requirements. Each field office bases its defective pricing audit requirements on its inventory of contracts and subcontracts subject to the act. When field office defective pricing inventories are incomplete, field offices understate their audit requirements which, in turn, understates DCAA's defective pricing work load.

For example, field offices were unaware of 2 subcontracts over \$10 million and 35 subcontracts between \$1 million and \$10 million in our sample. DCAA's 1991 instructions required it to include both these subcontracts over \$10 million and 1 in 10 contracts with a high risk of defective pricing between \$1 million and \$10 million in its audit requirements. However, because the field offices were unaware of the subcontracts, they did not

request resources for auditing them, therefore understating their audit requirements.

Having an incomplete inventory of subcontracts may result in a misallocation of audit resources among field offices. DCAA uses the field office inventories to allocate audit resources among offices by basing each field office's request for audit resources on each office's inventory. As a result, if field office inventories are incomplete, the offices' requests for audit resources may be understated and a misallocation of audit resources may occur.

DCAA's defective pricing program manager agreed that incomplete subcontract inventories may cause DCAA to understate or misallocate its resources between field offices. According to the program manager, the extent of the understatement or misallocation would depend upon the number of subcontracts omitted and whether they had a significant risk of defective pricing.

**Improvements to
Subcontract Identification
and Dissemination of
Information**

Some field officials we spoke with suggested that the process of developing an inventory of subcontracts could be considerably improved. These officials proposed modifying federal regulations to require prime contractors to report to DOD all subcontracts they negotiate that are subject to the Truth in Negotiations Act. This proposal would have the advantage of obtaining subcontract information as a part of the procurement process instead of requiring each DCAA field office to go to all contractors in its geographic area.

The three prime contractors included in our sample told us that, if such a requirement existed, any cost of compliance with a subcontract reporting requirement would be passed on to the government as part of the negotiated price. We did not evaluate the costs and benefits of this approach. However, it would not appear costly to develop a list of subcontractors included in a contractor's proposal at the time of negotiation. Contractors are required to obtain cost information from subcontractors; adding the contractors' names and locations for subcontracts subject to the act would not appear costly. We believe that the benefits of knowing the extent of the subcontract base subject to audit coverage, evaluating the risk and resources needed to cover that base, and performing audits in relation to the risks would more than outweigh the potential added costs.

In the absence of a mandatory contractor reporting system such as that previously mentioned, field offices should be required to share the information on subcontracts that is available to them under the current approach. We believe sharing information would improve the completeness of field office inventories. When we asked DCAA's program manager about the merits of sharing subcontract information between field offices, he said the potential benefits would have to be weighed against the costs in terms of auditor time. He told us that if auditors suspect defective pricing in subcontracts while auditing the prime contract, they can and do forward audit leads to the appropriate DCAA field office. He was unsure of the benefit to be gained by sharing information on those subcontracts where defective pricing was not suspected or the risk was unknown.

When we discussed procedures for sharing subcontract information with field officials, two expressed concern that the receiving office would feel obligated to audit subcontracts referred to it, possibly diverting audit resources from other contracts having a more significant defective pricing risk. We believe DCAA could provide guidance on how to handle subcontracts referred by other offices, thus avoiding potential misunderstandings.

Recommendations

We recommend that the Secretary of Defense examine the costs and benefits of changing the Defense Federal Acquisition Regulation Supplement to require prime contractors to notify the government of all subcontracts subject to the Truth in Negotiations Act. As an interim measure, we also recommend that the Secretary direct DCAA to require that when offices auditing prime contracts identify subcontract information, they share that information with the DCAA office responsible for auditing the subcontract.

Agency Comments

In commenting on this report, DOD acknowledged the importance of a complete and accurate universe of contracts and subcontracts and concurred with our findings and recommendations. DOD also outlined additional steps they plan to take to compile the universe. We plan to monitor DOD's future actions to address this, and other aspects, of DOD subcontract management. Our scope and methodology appear in appendix II and DOD's comments are presented in their entirety in appendix III.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of Defense; the Director, DCAA; the Director, Office of Management and Budget; and other interested congressional committees. Copies will also be made available to others upon request.

Please contact me at (202) 275-8400 if you or your staff have any questions concerning this report. Other major contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Paul F. Math". The signature is stylized with a large, sweeping initial "P" and "M".

Paul F. Math
Director, Research, Development, Acquisition,
and Procurement Issues

Contents

Letter	1
Appendix I The Defense Contract Audit Agency Selection and Planning Procedures for Defective Pricing Reviews for Fiscal Year 1991	14
Appendix II Scope and Methodology	16
Appendix III Comments From the Department of Defense	18
Appendix IV Questionnaire	20
Appendix V Major Contributors to This Report	24
Tables	
Table I.1: Matrix for Pricing Action Selections	15
Table II.1: Prime Contracts Covered in Review	16
Figures	
Figure 1: Subcontracts and Their Dollar Value	4
Figure 2: Dollar Value of Large and Small Subcontracts	5

Contents

Abbreviations

CPAF	cost-plus-award fee
CPFF	cost-plus-fixed Fee
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
FAO	Field Audit Office
GAO	General Accounting Office

The Defense Contract Audit Agency Selection and Planning Procedures for Defective Pricing Reviews for Fiscal Year 1991

At major contractors and nonmajor contractors with 5,000 or more prior year programmed hours of direct audit effort, field audit offices classify contractors as Category 1, 2, or 3 based on the following criteria. Nonmajor contractors with less than 5,000 prior year programmed hours of direct audit effort are not classified. However, pricing action selections are made using the matrix column for Category 3.

- Category 1: These are contractors with strong internal controls and consistent estimating and accounting systems. There are no known instances of wasteful, unlawful, or improper activities or practices that could reasonably relate to pricing. Defects occur infrequently and are corrected promptly when discovered. Proposals are well prepared, adequately supported, and updated in a timely manner. The incidence of questioned/unsupported cost and defective pricing is low.
- Category 2: These are contractors with fairly reliable systems, procedures, and controls. However, these contractors may have sporadic defective pricing, routine systems changes, periodic estimating system deficiencies, other unfavorable conditions, or infrequent occurrences of wasteful practices. These contractors have no known instances of significant unlawful or improper activities that could reasonably relate to pricing.
- Category 3: These contractors are known to have chronic systems deficiencies or investigations or referrals under Contract Audit Manual 4-702 (DCAA F2000). These contractors have significant instances of improper or unlawful practices. Any investigations or referrals should relate to pricing, if they are the sole basis for the category determination.

**Appendix I
The Defense Contract Audit Agency Selection
and Planning Procedures for Defective Pricing
Reviews for Fiscal Year 1991**

Table I.1 shows the matrix for the number of contract actions to be selected for audit by contract type, dollar strata and risk category. The last two rows in the matrix are for cost-plus-fixed fee (CPFF) type contracts and cost-plus-award fee (CPAF) type contracts.

Table I.1: Matrix for Pricing Action Selections

Contract type	Dollar strata	Number of eligible pricing actions to be reviewed		
		Category 1	Category 2	Category 3
Fixed priced	Over \$50 million (a)	All	All	All
	\$10 million - \$50 million	b	All	All
	\$1 million - < \$10 million	b	1 of 20	1 of 10
	\$100,000 - < \$1 million	b	1 of 100	1 of 50
Incentive	Over \$50 million (a)	All	All	All
	\$10 million - \$50 million	b	1 of 2	All
	\$1 million - < \$10 million	b	b	b
	\$100,000 - < \$1 million	b	b	b
CPFF/CPAF	Over \$100 million	c	b/c	b/c
	Under \$100 million	None	b/c	b/c

^aAll pricing actions over \$50 million are subject to defective pricing audit as soon as the office is aware of the award. Consider specific audit leads when planning these audits. Schedule these audits for completion no later than one program year after the year of award.

^bSelect pricing actions based on known conditions of contractor risk and/or a high probability of defective pricing. Nonselection is permissible if contractors are low risk or there are insufficient audit leads.

^cInclude CPAF and CPFF contracts in the defective pricing program for complete coverage. This is especially true for contracts with very large fixed fee or award fee provisions, and at contractors where audit work load consists entirely of cost type contracts.

Scope and Methodology

To develop a sample of subcontracts to use in testing the completeness of DCAA's inventory, we selected four prime contracts awarded between April 1985 and September 1986 to Boeing Defense and Space Group, Seattle, Washington; General Dynamics Corporation, Air Defense Systems Division, Pomona, California; and Textron Lycoming Stratford Division, Stratford, Connecticut. From each prime contractor we obtained listings of subcontracts—subject to the Truth In Negotiations Act—that were awarded under the basic prime contract.¹

Table II.1 shows the prime contracts covered in our review.

Table II.1: Prime Contracts Covered in Review

Dollars in millions			
Prime contractor	Prime contract number (item purchased)	Prime contract amount	DOD buying office
Boeing Defense and Space Group	F04701-85-C-0101 (Inertial Upper Stage launch vehicles)	\$203.7	Air Force Space Systems Division
Boeing Defense and Space Group	F04704-85-C-0050 (missile equipment)	\$221.6	Air Force Ballistic Missile Organization
General Dynamics Air Defense Systems Division	N00024-86-C-5301 (missile components)	\$330.5	Naval Sea Systems Command
Textron Lycoming Stratford Division	DAAE07-86-C-A050 (tank motors)	\$347.9	Army Tank - Automotive Command

We selected prime contracts awarded from 1985 through 1986 to provide sufficient time for DCAA field offices to include subcontracts subject to defective pricing in their inventories for 3 years. DCAA requires that subcontracts be included in inventories for 3 fiscal years after the year of the subcontract award. DCAA's guidance for developing its defective pricing inventories has not changed significantly since 1986. Therefore, we believe these prime contracts provide sufficiently current information to evaluate the extent to which field offices are including subcontracts in their defective pricing inventories.

¹The Army awarded contract DAAE07-86-C-0050 as a 5-year procurement totaling \$1.4 billion. It negotiated \$347,878,330 for the first year of the effort. We obtained listings of subcontracts awarded for the first year of the work.

To determine whether the field offices' inventories of subcontracts were complete, we sent a questionnaire to each DCAA field office responsible for auditing a subcontract under the prime contracts previously mentioned. (See app. IV.) The questionnaire asked the field office to identify those years (fiscal years 1985 through 1991) in which the subcontract had been included in its defective pricing inventory. Our methodology did not research the four recommended data sources in each of the 54 field offices to determine if the 211 subcontracts were, in fact, in the recommended data sources. In addition, it did not permit us to extend the results of our analysis to all defense subcontracts. However, we believe the results from our questionnaire demonstrate the lack of effectiveness of DCAA's current system for identifying subcontracts because we sent questionnaires to 54 of 152 field offices.

We reviewed applicable federal laws such as the Truth in Negotiations Act (P.L. 87-653, codified at 10 U.S.C. 2306a), DOD regulations, and DCAA regulations and guidance on its defective pricing program. We interviewed selected DCAA officials responsible for the defective pricing program at DCAA headquarters in Washington, D.C.; and visited field offices located in Seattle, Washington; San Diego, California; and Stratford and Windsor Locks, Connecticut.

We conducted our review between March 1991 and February 1992 in accordance with generally accepted government auditing standards.

Comments From the Department of Defense



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

MAY 13 1992

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, entitled "CONTRACT PRICING: Defense Contract Audit Agency's Audit Coverage Lowered By Lack of Subcontract Information," dated April 8, 1992 (GAO Code 396681/OSD Case 9029). The Department concurs with all of the draft report findings and recommendations.

The Department acknowledges the importance of a complete and accurate universe of contracts and subcontracts subject to the Truth in Negotiations Act. Preparation of the universe has been a long term concern, because there is no sole data source of contracts and subcontracts subject to the Act. The Defense Contract Audit Agency has taken aggressive management actions to develop a more complete and more accurate universes. Despite these efforts, however, auditors continue to encounter shortcomings in the data available or methods used to develop a universe of contracts and subcontracts. The Department recognizes that the lack of such data directly affects its ability to enforce the provisions of 10 U.S.C. 2306a.

Detailed DoD comments in response to the GAO recommendations are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in cursive script, appearing to read "Alvin Tucker".

Alvin Tucker
Deputy Comptroller
(Management Systems)

Appendix III
Comments From the Department of Defense

GAO DRAFT REPORT--DATED APRIL 8, 1992
(GAO CODE 396681) OSD CASE 9029

"CONTRACT PRICING: DCAA'S AUDIT COVERAGE LOWERED BY
LACK OF SUBCONTRACT INFORMATION"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense examine the costs and benefits of changing the Defense Federal Acquisition Regulation Supplement to require prime contractors to notify the Government of the award of all subcontracts subject to the Truth in Negotiations Act. (p. 15/GAO Draft Report)

Now on p. 10.

DoD RESPONSE: Concur. By May 22, 1992, the Office of the Comptroller, DoD, will request that the Defense Contract Audit Agency initiate a Defense Acquisition Regulation case on the issue of requiring prime contractors to notify the Government of all subcontracts subject to the Truth in Negotiation Act. It is anticipated that the case will be completed and ready for submission by June 30, 1992.

RECOMMENDATION 2: The GAO recommended that, as an interim measure, the Secretary of Defense direct the Defense Contract Audit Agency to require that when offices auditing prime contracts identify subcontract information the information be shared with the Defense Contract Audit Agency office responsible for auditing the subcontract. (p. 15/GAO Draft Report)

Now on p. 10.

DOD Response: Concur. The Defense Contract Audit Agency through its Program Objective Document to field offices (which is expected to be issued at the end of May 1992), will (1) emphasize that subcontracts should be identified during prime contract audits and (2) direct that such information be shared with those offices responsible for performing subcontract audits, including defective pricing audits. The Defense Contract Audit Agency is committed to making every reasonable effort to establish a complete contract and subcontract universe.

Questionnaire

U.S. General Accounting Office Review of DCAA Audit Coverage of Subcontractors

LABEL

The U.S. General Accounting Office, an agency of the Congress, is conducting a study of the Defense Contract Audit Agency's coverage of subcontracts. The subcontract listed below was selected for inclusion in this study. Note: Although the subcontractor may have several subcontracts, please complete this questionnaire only in reference to the one noted below.

Please complete and return this form to us within two weeks. You may "fax" the form to us at (206) 287-4872 or if you prefer to mail it, a pre-addressed business reply envelope is enclosed for your convenience. If you do "fax" the questionnaire, please do not forget to mail us the accompanying documentation. If you have any questions, please call Laurie Jones or Dave Robinson on (206) 287-4800.

SUBCONTRACT INFORMATION

1. Prime contractor for this subcontract:
(Supplied by GAO)
2. Contract Number for prime contractor:
(Supplied by GAO)
3. Subcontractor:
(Supplied by GAO)

4. Contract Number for subcontractor:
(Supplied by GAO)
5. Subcontract Award Date:
(Supplied by GAO)
6. Subcontract Award Amount:\$ (Supplied by GAO)
7. FAO Official Completing this survey:
Name: _____
Title: _____
Phone number including area code:
() - _____

8. Review the responses to questions one through six. Are there any errors in the responses printed?(Check One.)

1. No
2. Yes

If yes, please correct the response by writing in the correct information immediately below the question.

3. Unable to respond because the FAO lacks information on this contract.

SUBCONTRACT AUDIT COVERAGE

9. Since this subcontract's award date, has your FAO included it in your defective pricing universe for any fiscal/management year?(Check One.)
1. No (SKIP TO QUESTION 12)
 2. Yes

Appendix IV
Questionnaire

10. Check the management/fiscal year(s) that this subcontract was included in the FAO's defective pricing audit universe. (Check All That Apply)

- 1. MY/FY 1985
- 2. MY/FY 1986
- 3. MY/FY 1987
- 4. MY/FY 1988
- 5. MY/FY 1989
- 6. MY/FY 1990
- 7. MY/FY 1991

For each year checked above, please provide, for documentation, a copy of the page within the audit universe listing the subcontractor, the subcontract, and dollar amounts.

11. Check the sources below, if any, that your FAO used to identify this specific subcontract for inclusion in your audit universe. (Check all that apply.)

- 1. Forward-pricing (pre-award) audit by the FAO.
- 2. Contract listing obtained from the prime contractor.
- 3. Contract listing obtained from the subcontractor.
- 4. FAO Management Information System (FMIS) Report - (formerly the Management Information System (MIS).
- 5. FAO Assignment Control System (FACS) Report.
- 6. Defense Contract Management Command contract listing.
- 7. Annual Overhead Claim Letters.
- 8. Referral from another DCAA office.
- 9. Requested by government contracting officer.
- 10. Other (Please specify)

12. Since this subcontract's award date, has your FAO included it in your defective pricing audit requirements plan for any fiscal/management year? (Check One.)

- 1. No (SKIP TO QUESTION 15)
- 2. Yes

13. Check the management/fiscal year(s) that this subcontract was included the FAO's audit requirements plan. (Check All That Apply)

- 1. MY/FY 1985
- 2. MY/FY 1986
- 3. MY/FY 1987
- 4. MY/FY 1988
- 5. MY/FY 1989
- 6. MY/FY 1990
- 7. MY/FY 1991

For each year checked above, please provide, for documentation, a copy of the page within the audit requirements plan listing the subcontractor, the subcontract, and dollar amounts.

**Appendix IV
Questionnaire**

14. For each year your FAO included this subcontract in its defective pricing audit requirements, what criteria was used in making this determination? Mark each criteria that applies for the applicable year.

	MY FY 85 (1)	MY FY 86 (2)	MY FY 87 (3)	MY FY 88 (4)	MY FY 89 (5)	MY FY 90 (6)	MY FY 91 (7)
1. Mandatory selection: chosen using matrix criteria (dollar threshold)							
2. Discretionary selection: Identified based on overall circumstances/risks							
3. Mandatory selection: Requested by others							
4. Mandatory selection: Specific audit lead that identified a high probability of defective pricing							
5. Others: (Specify) _____ _____							

15. Since the subcontract's award date has it been programmed for a defective pricing audit in any fiscal/management year? (Check One.)

- 1. No (SKIP TO QUESTION 17)
- 2. Yes

16. Check the statement below that best describes the status of these defective pricing audits that have (had) been programmed for the specific subcontract. (Check One.)

- 1. All programmed audit(s) for the subcontract have been completed. (Please provide copies of the completed audit reports.)
- 2. Some programmed audit(s) for the subcontract have been completed and some remain in process or open. (Please provide copies of the completed audit reports.)
- 3. All programmed audit(s) for the subcontract remain open or are in process.
- 4. All programmed audit(s) for the subcontract have not yet been started.
- 5. Other (Please specify)

**Appendix IV
Questionnaire**

17. Since March 1988, has your FAO issued any initial, follow up, or flash estimating system reports on the subcontractor identified in question 3. (Check One.)

1. No

2. Yes (Please provide copies of the reports.)

18. For each of the fiscal/management years listed below, please check the category of risk that your FAO assigned to the subcontractor listed in item 3 for contract selection purposes? Check one for applicable year.)

Risk Category	MY						
	FY						
	85	86	87	88	89	90	91
1. Category 1							
2. Category 2							
3. Category 3							
4. Unassigned: Please explain : _____ _____							

Please return this questionnaire and its accompanying documentation to:

U.S. General Accounting Office
915 Second Avenue Room 1992
Seattle, Washington 98174
Attn: Dave Robinson

Major Contributors to This Report

**National Security and
International Affairs
Division,
Washington, D.C.**

**Charles W. Thompson, Assistant Director
John L. Carter, Assignment Manager**

Seattle Regional Office

**William R. Swick, Regional Defense Issues Manager
David A. Robinson, Evaluator-in-Charge
Susie Anshell, Evaluator
Laurie Macfadden Jones, Evaluator
Stanley G. Stenersen, Evaluator
Robert J. Aiken, Computer Analyst**