Policy and Oversight

Contract Audit Directorate

Evaluation Report on Dispositioned Defective Pricing Audit Reports at the Warner Robins Air Logistics Center

Report Number PO 97-045 September 24, 1997

Office of the Inspector General
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Acronyms

CO	Contracting Officer
DCAA	Defense Contract Audit Agency
FAR	Federal Acquisition Regulation
OMB	Office of Management and Budget
RPA	Recommended Price Adjustment
TINA	Truth in Negotiations Act
U.S.C.	United States Code
WRALC	Warner Robins Air Logistics Center

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 24, 1997

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE
(ACQUISITION)
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Evaluation Report on Dispositioned Defective Pricing Audit Reports at the Warner Robins Air Logistics Center (Report No. PO 97-045)

We are providing this evaluation report for your information and use. The report is one in a series relating to our review of dispositioned defective pricing reports at selected DoD buying commands.

We provided a draft of this report to you on August 13, 1997. Because the report contains no findings or recommendations, comments were not required, and none were received. Therefore, we are publishing this report in final form.

We appreciate the courtesy extended to the evaluation staff. For additional information on this report, please contact Ms. Veronica H. Harvey, Evaluation Project Manager, at (703) 604-8740 (DSN 664-8740). See Appendix D for the report distribution. The evaluation team members are listed inside the back cover.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Office of the Inspector General, DoD

Report No. PO 97-045 **September 24, 1997**
(Project No. 7OC-9013.02)

Dispositioned Defective Pricing Audit Reports at the Warner Robins Air Logistics Center

Executive Summary

Introduction. This report is one in a series relating to our FY 1997 evaluation of dispositioned defective pricing reports at selected DoD buying commands. DoD Directive 7640.2, "Policy for Followup of Contract Audit Reports," requires the Office of Inspector General, DoD, to develop contract audit followup policy and to monitor, coordinate, and evaluate contract audit followup systems maintained by the DoD Components. As prescribed by the Directive, the Office of the Inspector General has the responsibility to identify areas where contract audit followup procedures can be improved and to recommend appropriate corrective action to the respective DoD Component head. In accordance with those responsibilities, the Office of the Inspector General has conducted periodic oversight reviews of major DoD buying commands every 2 to 3 years since 1983. The reviews covered open and closed reports with special emphasis on defective pricing audit reports because they represented the bulk of reportable audits at major buying commands. We selected Warner Robins Air Logistics Center for this project because we last reviewed it in January 1994 and because our analysis of the semiannual reports for the sample period showed its contracting officers dispositioned 24 defective pricing audit reports with $5.5 million in recommended price adjustments.

Evaluation Objectives. The overall objective was to determine whether contracting officers at the Warner Robins Air Logistics Center followed statutory and regulatory guidance in processing and dispositioning defective pricing reports. Specifically, we determined whether contracting officers at the Center took timely and appropriate actions to disposition defective pricing reports, including recovery of contract overpayments and applicable statutory interest. We also evaluated the adequacy of Defense Contract Audit Agency coverage of postaward audits and support to contracting officers as well as the adequacy of the Center's management controls applicable to the stated objective.

Evaluation Results. The contracting officers at Warner Robins Air Logistics Center effectively resolved and dispositioned defective pricing audit reports during the sampled period. In dispositioning the reports, contracting officers generally followed statutory and regulatory guidelines. Contracting officers issued timely and proper demands for payment and properly assessed, collected, and credited the appropriate U.S. Treasury account when they collected interest on contractor overpayments.

We did not observe any conditions that warranted further review of the adequacy of the Defense Contract Audit Agency postaward audit coverage of the Warner Robins Air Logistics Center contracts.

Appendix A discusses the review of the Warner Robins Air Logistics Center management control program.

Management Comments. This report contains no recommendations; therefore, written comments were not required, and none were received.

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Part I - Evaluation Results

Evaluation Background

Office of Management and Budget (OMB) Circular A-50, "Audit Followup," requires that resolution of contract audit reports, other than preawards, be achieved within 6 months of report issuance and that disposition take place as soon as possible after resolution. The DoD Directive 7640.2, "Policy for Followup of Contract Audit Reports," as amended August 16, 1995, implements the OMB Circular and provides policy and procedural guidance to DoD Components for the resolution and disposition of specified contract audit reports. The Directive requires the Office of the Inspector General, DoD, to develop contract audit followup policy and to monitor and evaluate contract audit followup systems maintained by the DoD Components. Defective pricing audit reports issued by the Defense Contract Audit Agency (DCAA) are covered by the Directive.

In accordance with assigned responsibilities, the Office of the Inspector General, DoD, conducts periodic comprehensive oversight reviews of major DoD commands to determine the adequacy of their implementation of the Directive. This evaluation report summarizes our review of resolution and disposition actions taken on defective pricing audit reports by Warner Robins Air Logistics Center (WRALC) contracting officers. Appendix B summarizes prior evaluations at WRALC.

Evaluation Objectives

The overall objective was to determine whether contracting officers at WRALC followed statutory and regulatory guidance in processing and dispositioning defective pricing audit reports. Specifically, we determined whether contracting officers at WRALC took timely and appropriate actions to disposition defective pricing reports, including recovery of contract overpayments and applicable statutory interest. We also evaluated the adequacy of DCAA coverage of postaward audits and support to contracting officers as well as the adequacy of WRALC management controls applicable to the stated objective. See Appendix A for a discussion of the evaluation process and the results of our review of the management control program.

Processing and Dispositioning Defective Pricing Audit Reports

Contracting officers (COs) at the WRALC effectively processed and dispositioned defective pricing audit reports issued by the DCAA. COs consistently followed statutory and regulatory guidance; issued timely and proper demands for payment; and properly assessed, collected, and credited the appropriate U.S. Treasury account when interest on contractor overpayments was due. COs dispositioned 24 defective pricing audit reports with $5.5 million in recommended price adjustments during the 18-month sample period. Of the $5.5 million in recommended price adjustments, WRALC COs sustained $3.3 million equaling a 60-percent sustention rate, which exceeds by 12 percent, the 48-percent benchmark historically experienced by DoD contracting and contract management activities. In addition, the high sustention rate reflects the quality of audits and support provided by DCAA.

DoD Directive 7640.2 Requirements

Resolution Requirements. The DoD recognizes, under OMB Circular A-50 and DoD Instruction 7600.2, "Audit Policies," the need for COs to give full consideration to contract audit advice and to document the disposition of audit recommendations. OMB Circular A-50 require resolution of contract audit reports, other than preawards, within 6 months of report issuance. DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports," February 12, 1988, states that resolution is the point at which the auditor and the CO agree on the action to be taken on audit report findings and recommendations or, in the event of disagreement, when the CO determines a course of action after following the DoD Component prenegotiation documentation and review procedures.

The CO is responsible for reaching agreement with the contractor and has wide latitude and discretion in that regard. For most contract audit reports, the CO should obtain contractor comments and the technical advice deemed necessary before resolution or formulation of the Government prenegotiation position. The additional information is to be shared with the DCAA auditor, as appropriate. If additional audit effort is required, the CO must promptly request the audit, and the DCAA auditor must give priority to providing the additional audit support. The DCAA auditor is required to adjust the recommended price adjustment (RPA) if additional factual data warrant the change. If no additional audit effort is necessary, the CO must communicate with the auditor on the proposed disposition, as necessary, to reach a fully informed decision. The Directive requires contracting officers to document resolution. Disposition should take place as soon as possible after resolution.

Disposition Requirements. Contract audit report disposition is achieved when the contractor implements the audit recommendations or the contracting officer decision; the CO negotiates a settlement with the contractor and a contractual document is executed; or the CO issues a final decision pursuant to the Disputes clause in Federal Acquisition Regulation (FAR) 52.233-1, and 90 days elapse without contractor appeal to the Armed Services Board of Contract Appeals.

Timely Resolution and Disposition of Defective Pricing Audits. The contract files indicated that WRALC COs actively pursued resolution and disposition of DCAA audit reports, except when reports were involved in litigation or were under investigation, or when reasons beyond the control of the CO caused the delay. Of the 24 audit reports included in the evaluation, only 9 were not resolved within the 6-month period prescribed by the Directive. Resolution was delayed in six cases because of litigation and in three cases because of other reasons beyond the control of the CO. In regard to disposition, all but 8 of the 24 reports reviewed were promptly dispositioned following resolution. In dispositioning reports, COs took actions that were consistent with statutory and regulatory guidelines.

Collection of Contract Debts and Statutory Interest

The WRALC effectively settled defective pricing audits reported during the three semiannual reporting periods ended September 30, 1995; March 31, 1996; and September 30, 1996. COs promptly issued demands for payment and accurately assessed interest when applicable. Contract debts were promptly collected and credited to the proper accounts in accordance with DoD accounting procedures.

Defective Cost or Pricing Data. The FAR 15.804-7 implements Public Law 87-653, "The Truth in Negotiations Act," as amended, and prescribes the polices and procedures for adjusting defectively priced contracts (see Appendix C). If after contract award, cost or pricing data are found to be inaccurate, incomplete, or noncurrent as of the date of final agreement on price shown on the contractor's or subcontractor's Certificate of Current Cost or Pricing Data, the Government is entitled to a price adjustment, including profit or fee, on any significant amount by which the contract price was increased because of the defective data. In addition to the price adjustment amount, the Government is entitled to interest on any overpayments and to penalty amounts on certain overpayments.

Demand for Payment of Contract Debt. The FAR 32.610 requires that "a demand for payment shall be made as soon as the responsible official has computed the amount of refund due." In the demand for payment, the CO is required to separately identify the repayment amount; the penalty amount, if any; the interest amount through a specified date; and a statement that interest will continue to accrue until repayment is made. The demand provides the contractor with instructions on how, when, and where to repay a contract debt, and informs comptroller officials to establish an account receivable. For active defectively priced contracts, the contract adjustment should result in a reduction of the contract price or cost allowance, as appropriate, to prevent further

overpayments on future deliveries. However, when payments have been made for delivered goods or services, a demand for the amounts overpaid and applicable interest from the date of overpayment until receipt of repayment from the contractor is also necessary. The DoD Accounting Manual 7220.9-M, chapter 33 E.3.a., requires that "Interest charges collected shall be deposited directly into Treasury receipt account 3210, General Fund Proprietary Receipts, Defense Military, Not Otherwise Classified."

WRALC Processing of Defective Pricing Audits. The 24 defective pricing audit reports we reviewed contained recommended price adjustments totaling $5.5 million. The contract files indicated that WRALC COs issued proper and timely demands for payment and sustained $3.5 million of the $5.5 million in recommended price adjustments. The $3.5 million equated to a 60-percent sustention rate, which exceeds by 12 percent, the 48-percent benchmark historically experienced by DoD contracting and contract management activities in defective pricing settlements. A prior Inspector General, DoD, review (see Appendix B) determined that a sustention rate of about 48 percent was experienced by DoD acquisition and contract administration organizations as a whole in dispositioning defective pricing audit reports. In addition, WRALC COs properly assessed, collected, and credited $1.3 million in interest to the U.S. Treasury receipt account 3210, General Fund Proprietary Receipts, Defense Military, Not Otherwise Classified.

DCAA Contract Audit Support

During our review of contract files, we did not observe any conditions that warranted further review of the adequacy of DCAA postaward audit coverage of WRALC contract actions. As indicated by the WRALC high rate of sustension, the DCAA audit-recommended price adjustments were well founded and supported during negotiations. Our review indicated that DCAA field audit offices responded to WRALC CO requests for followup audit support and that WRALC COs used the services of the on-site DCAA Procurement Liaison Auditor during fact-finding and negotiations of complex or contentious issues with contractors.

Part II - Additional Information

Appendix A. Evaluation Process

Scope

Work Performed. We conducted an evaluation of dispositioned defective pricing audit reports at Warner Robins Air Logistics Center (WRALC), Robins Air Base, Georgia, the week of January 20, 1997. The evaluation, announced on October 21, 1996, was spun off Project No. 7OC-9-013, "Evaluation of Dispositioned Defective Pricing Audit Reports at Selected DoD Buying Commands" to facilitate implementation of corrective action at buying commands, where we found significant deficiencies in the processing of defective pricing audit reports.

The initial project scope involved the review and evaluations of closed defective pricing audit reports at selected DoD major commands. For the initial project, we selected four major buying commands, the U.S. Army Aviation and Troop Command, St. Louis, Missouri; the WRALC, Robins Air Force Base, Georgia; the Naval Air Systems Command, Arlington, Virginia; and the National Agency, Maryland Procurement Office, Fort Meade, Maryland. We selected those four major commands based on the number of defective pricing audit reports closed during the 18-month sampled period (the reporting periods ended September 30, 1995; March 31, 1996; and September 30, 1996); the total dollar recommended price adjustments; total costs sustained; and date of the last Inspector General, DoD, oversight review.

We also evaluated the adequacy of DCAA postaward coverage of contracts and support of contracting officers; however, we did not observe significant indicators that warranted further review of specific DCAA field audit offices.

Limitations of Evaluation Scope. We limited our review to cover only defective pricing audits dispositioned during the three semiannual reporting periods ended September 30, 1995; March 31, 1996; and September 30, 1996. Prior reviews covered open and closed reports with special emphasis on defective pricing audit reports because they represented the bulk of reportable audits. Since 1983, the Office of the Inspector General, DoD, has been conducting comprehensive contract audit followup reviews of major DoD buying commands and Defense agencies, in accordance with DoD Directive 7640.2.

Methodology

To determine whether DoD contracting officers complied with statutory, regulatory, and agency guidelines in processing defective pricing audit reports with recommended price adjustments, we reviewed the following:

o existing statutory, regulatory, and agency guidelines on defective pricing;

o contract file documentation, such as price-reduction modifications, contracting officer final decisions, demand letters, prenegotiation and postnegotiation business clearances, followup correspondence, and memorandums for record;

o method of recovery and the status of recovery of funds actions;

o assessment and collection of statutory interest and penalties and posting of recovered funds;

o defective pricing audit reports, subcontractor assist audit reports and supplements thereto; DCAA rejoinders, fraud referrals (if any), and other advisory memorandums; and

o communications and correspondence between contracting officers, contractors, contract auditors, and payment or accounting and finance offices.

Use of Computer-Processed Data. We relied on computer-processed data from the Office of the Inspector General, DoD, Contract Audit Reporting and Tracking System to determine the contracting activities to visit and to determine the evaluation sample selection. That system is a database comprised of semiannual reports submitted by the DoD Components to the Office of the Inspector General, DoD. Although we did not initially perform a formal reliability assessment of the computer-processed data before sample selection, we ran the built-in error checks to test the reliability of the data. During the field work, we traced the sampled data from the Contract Audit Reporting and Tracking System to source documentation, such as audit reports, business clearance memorandums, and other contract file documents. When we found reporting errors, we adjusted the sample universe to correct the reported statistics.

Sample Universe. We limited the sample to cover the 24 defective pricing audit reports that WRALC reported closed during the 18-month sampled period.

Evaluation Type, Dates, and Standards. We performed this program evaluation of the closed defective pricing audits at the WRALC during the week of January 20, 1997, in accordance with standards implemented by the Inspector General, DoD. Criteria for performing the evaluation are set forth in the OMB Circular A-50, "Audit Followup," as implemented by DoD Directive 7640.2. Accordingly, we included tests of management controls considered necessary.

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

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program" August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of WRALC management controls covering the resolution and disposition of defective pricing audit reports with recommended price adjustments. We also reviewed the adequacy of the controls for the WRALC contract audit followup tracking and reporting system to monitor the resolution and disposition status of defective pricing reports in accordance with DoD Directive 7640.2 and OMB Circular A-50.

Adequacy of Management Controls. The WRALC maintained adequate management controls in that we identified no material weaknesses in the 24 defective pricing audits closed during the 18-month sampled period.

Appendix B. Summary of Prior Coverage

Contract Audit Followup Oversight Reviews October 1989 and January 1994. The objective of the reviews was to determine whether the WRALC maintained an effective contract audit followup system. The results of the reviews showed that WRALC maintained an effective contract audit followup program and that contracting officers generally followed statutory, regulatory, and agency guidance when resolving and dispositioning audit reports issued by the DCAA.

Inspector General, DoD, Report No. AFU91-1, "Nonsustention of Costs Questioned in Postaward Contract Audit Reports," October 11, 1990. This study included a systematic, historical review of dispositioned audit reports to better understand why DoD contracting officers did not sustain audit-questioned costs. The study used a statistical sample of 326 audit reports from a universe of 6,866 reports closed over a 2-year period. The report concluded that a sustention rate of 48 percent for defective pricing audit reports was a reasonable benchmark for indicating that DoD contracting and contract management activities were making adequate use of audit advice.

Appendix C. Statutory and Regulatory Guidance on Defective Pricing

The Truth in Negotiations Act. In 1962, Congress passed Public Law 87-653, The Truth in Negotiations Act (TINA), currently codified at Section 2306a of Title 10, United States Code (U.S.C.). TINA applies to DoD, National Aeronautics and Space Administration, and U.S. Coast Guard negotiated contracts entered into, on or after February 15, 1987. Before, February 15, 1987, 10 U.S.C. 2306(f) contained the necessary provisions. The TINA requires Government contractors to submit cost or pricing data and to certify that such data are accurate, complete, and current upon agreement on price. More important, TINA requires a downward adjustment to the contract price, including profit or fee, when it is determined that the contract price was increased because the contractor submitted defective cost or pricing data and that the Government relied on the data submitted. The TINA was enacted to place the Government CO or negotiator on equal footing with the contractor during negotiations. The legislative intent was to give the Government informational parity with contractors and subcontractors during price negotiations so the Government could avoid excessive prices. The DoD assigned the primary responsibility of testing contractor compliance with the TINA to DCAA. The DCAA is responsible for establishing a program for performing postaward audits on noncompetitively awarded contracts and subcontracts. Guidance on defective pricing is in the DCAA Contract Audit Manual 14-100, section 1, "Postaward Audits of Contractor Cost or Pricing Data," and the detailed audit steps are in the audit program for postaward audits.

In 1985, the Congress enacted a statutory provision making contractors liable for interest on overpayments made by the Government as a result of defective cost or pricing data and for a penalty in the amount equal to the amount of the overpayment, if the submission of defective cost or pricing data was a knowing submission (section 934 of the DoD Authorization Act for FY 1986, P.L. 99-145). The following year, due to renewed concerns over contractor overcharging, the Congress again amended the TINA in section 952 of the DoD Authorization Act for FY 1987, P.L. 99-500. The amendment eliminated certain contractor defenses and clarified the offset provisions. Additionally, it provided a statutory definition of "cost or pricing data."

Federal Acquisition Circular 90-3. In January 1991, the Director, Defense Procurement, issued regulations implementing 10 U.S.C. 2306a in Federal Acquisition Circular 90-3. The Circular defined for the first time in the FAR that overpayment occurs only when payment is made for supplies or services accepted by the Government. Before that time, various definitions of "overpayment were used, the most common being that an overpayment could occur only on a contract after all funds had been paid to the contractor. For overpayments on contracts and modifications entered on or before November 7, 1985 (prior to the applicability of 10 U.S.C. 2306a[3]), any amounts not paid within 30 days from the date of the demand or from any earlier date specified in the contract, interest shall be assessed at the rate established by the Secretary of

the Treasury for the period affected. During the 5-year period between the enactment of the interest provisions and their implementation by the Director, Defense Procurement, the DoD Components made efforts to implement the provisions at the buying command level.

10 U.S.C. 2306[e]. This law makes contractors liable for interest at the underpayment rate in effect for each quarter from the time of overpayment to the time of repayment, using the rates prescribed by the Secretary of the Treasury under 26 U.S.C. 6621(a)2.

Appendix D. Report Distribution

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Evaluation Team Members

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

Maurice G. Nestor
Bonnie Weiss
Veronica Harvey
Nancy C. Cipolla
Ana A. King