Audit Report

OFFICE OF THE INSPECTOR GENERAL

DOD PROCUREMENTS FROM FEDERAL PRISON INDUSTRIES

Report Number 92-005 October 11, 1991

Department of Defense

The following acronyms are used in this report.

DCAA.....Defense Contract Audit Agency
DESC.....Defense Electronics Supply Center
DFARS.....Defense Federal Acquisition Regulation Supplement
DGSC.....Defense General Supply Center
FAR.....Federal Acquisition Regulation
FFRDC.....Federally Funded Research and Development Center
FPI.....Federal Prison Industries, Inc.
GAO.....General Accounting Office
NSN.....National Stock Number
SPCC.....U. S. Navy Ships Parts Control Center
TACOM.....U.S. Army Tank-Automotive Command
UNICOR.....Trade Name for Federal Prison Industries

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

October 11, 1991

MEMORANDUM FOR DIRECTOR OF DEFENSE PROCUREMENT
ASSISTANT SECRETARY OF THE ARMY
(FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on DoD Procurements from Federal Prison Industries (Report No. 92-005)

We are providing this final report for your information and use. Comments on a draft of this report were considered in preparing this report, which resulted from a Hotline allegation.

DoD Directive 7650.3 requires all recommendations within DoD to be resolved promptly. Therefore, we request that the Director of Defense Procurement, the Assistant Secretary of the Navy, and the Directors of Defense Contract Audit Agency and Defense Logistics Agency provide final comments on the unresolved recommendations by December 11, 1991. DoD Directive 7650.3 also requires that comments indicate concurrence or nonconcurrence in each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements.

If you nonconcur with the estimated monetary benefits or any part thereof, you must state the amount you nonconcur with and the basis for your nonconcurrence. Recommendations and potential monetary benefits are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weaknesses highlighted in Part I.

We appreciate the courtesies extended to the audit staff. If you have any questions on this audit, please contact Mr. James J. McHale, Program Director, at (703) 614-6257 (DSN 224-6257) or Ms. Victoria C. Hara, Project Manager,

at (703) 614-6263 (DSN 224-6263). Copies of the final report will be distributed to the activities listed in Appendix H. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army
Secretary of the Navy
Under Secretary of Defense for Acquisitions
Assistant Secretary of Defense (Production and Logistics)
Chief Executive Officer, Federal Prison Industries

Office of the Inspector General, DoD

AUDIT REPORT NO. 92-005 **October 11, 1991**
(Project No. 0CH-8010)

FINAL AUDIT REPORT ON DOD PROCUREMENTS FROM FEDERAL PRISON INDUSTRIES

EXECUTIVE SUMMARY

Introduction. Federal Prison Industries (trade name UNICOR) is a wholly owned Government corporation, created by Congress in 1934. The mission of UNICOR is to support the Federal Bureau of Prisons by employing and training Federal inmates through the operation and earnings of factories producing products and services for the Federal Government. For FY 1990, UNICOR had sales of $343 million to Federal agencies, and DoD purchased $212 million of the total. For the 13 National Stock Numbers for electrical and electronic cables purchased by DoD, UNICOR was the only producer for the last 2 to 19 years.

Objectives. The objectives of the audit were to determine the validity of a Hotline allegation concerning the pricing of certain electronic and electrical cables procured from UNICOR and to examine the reasonableness of prices paid for other similar items procured by DoD from UNICOR. We also evaluated the adequacy of internal controls within DoD related to procurements from UNICOR.

Audit Results. We recognized that UNICOR had operational difficulties and limitations posed by their unique mission and the need for UNICOR to achieve sufficient earnings to allow for the incorporation of an expanding prison population into UNICOR. Nevertheless, the audit showed that prices paid for electronic and electrical cables purchased from UNICOR often exceeded costs and negotiated profits. The DoD contracting officers did not require UNICOR to submit certified cost or pricing data as required by Federal Acquisition Regulation 15.804 "Exemption of Submission of Certified Cost or Pricing Data," and Public Law 87-653, Truth in Negotiations Act, and did not adequately protect the interests of DoD when determining whether prices quoted by UNICOR were fair and reasonable. As a result, 48 of the 54 contracts (55 work orders), valued at $11.7 million, were overpriced by $1.8 million (Appendix A). In addition, five contracts, valued at $786,133, were priced at a loss of $288,047 to UNICOR and one contract, valued at $1.5 million, had a fair and reasonable price (Appendix B).

Internal Controls. Internal controls pertaining to procurement procedures for obtaining and analyzing contract cost and pricing data were not adequate to ensure fair and reasonable prices. See Part I and the finding for details of these weaknesses.

Compliance with Laws and Regulations. DoD contracting officers did not comply with Federal Acquisition Regulations and Defense Federal Acquisition Regulations when contracting with UNICOR. The Federal Acquisition Regulation establishes policies and procedures for: submission of cost or pricing data; price negotiations; assessment of the adequacy of the estimating system of the contractor; inclusion of contract clauses; and determination of the allowability, allocability, and reasonableness of proposed costs.

Potential Benefits of Audit. We identified potential monetary benefits of an estimated $1.8 million and improved compliance with acquisition regulations (see Appendix F).

Summary of Recommendations. We recommended that DoD coordinate with UNICOR on the parameters of reasonableness for UNICOR profits and the type of data DoD contracting officers need to negotiate prices on UNICOR contracts. We also recommended training for procurement personnel and the implementation of additional internal controls. In addition, we recommended that DoD request a voluntary refund of $1.8 million and review other contracts with UNICOR for potential overpricing.

Management Comments. Since issuance of the draft report, the Office of the Director of Defense Procurement has been working with UNICOR on profit and pricing procedures. The Army agreed to request a refund and to review other contracts. These actions fully comply with the recommendations of the report. We received comments from the Defense Contract Audit Agency; however, we were informed that they intend to revise their comments, which we will consider as comments to the final report. As of October 11, 1991, the Director of Defense Procurement had not responded to the draft report. The Navy and Defense Logistics Agency comments were received too late to be included in the report. We request responses to the final report, indicating concurrence or nonconcurrence with the recommendations by December 11, 1991. Although no response was requested, the Chief Executive Officer, Federal Prison Industries, provided comments that stated that UNICOR was working to improve cost estimating and accumulation weaknesses as listed in our previous management letter to UNICOR. However, he did not agree with the report findings on overpricing. We stand by our findings. A synopsis of the Chief Executive Officer comments and audit response to the comments are at Appendix I, and the complete text of the comments is in Part IV.

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This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 693-0340.

PART I - INTRODUCTION

Background

Federal Prison Industries (trade name UNICOR) is a wholly owned Government corporation, created by Congress in 1934. UNICOR exists under the Department of Justice; however, it is an incorporated entity of the District of Columbia operating on a nonappropriated fund basis. The mission of UNICOR is to support the Federal Bureau of Prisons by employing and training Federal inmates through the operation and earnings of factories that produce products and perform services for the Federal Government. Earnings from these products and services are used for preindustrial training, for purchase of new equipment, for renovation of existing factories, and for capital expansion.

UNICOR is governed by a board of directors, whose members are appointed by the President of the United States. The board represents interests of industry, labor, agriculture, retailers and consumers; the Department of Defense; and the Attorney General. Disputes as to price, quality, character, or suitability of UNICOR products are arbitrated by a board consisting of the Comptroller General, the Administrator of the General Services Administration, and the President of the United States, or their representatives. Discussions with procurement officials, however, revealed that the arbitration board is not a viable option because of the high-level of the individuals or their representatives involved.

Objectives

The audit objectives were to:

- o determine the validity of the Hotline allegation concerning pricing of electronic and electrical cables procured from UNICOR,

- o examine the reasonableness of prices paid for other similar items procured by DoD from UNICOR, and

- o evaluate the adequacy of internal controls within DoD, related to procurements from UNICOR.

Scope

Hotline allegation. We reviewed 11 contracts for electronic and electrical cables with a combined value of $52,293 awarded during 1986 through 1990 (Appendix A). We reviewed records at the Defense General Supply Center (DGSC) and UNICOR.

Other items. The universe was determined based on a computer-processed database of contract actions $25,000 and above (DD Form 350, "Individual Contract Actions Report") for FY 1989. We did not establish the reliability of these data because the primary purpose of this objective was to examine the reasonableness of prices paid for the selected individual items procured by DoD from UNICOR. Accordingly, our initial selection of contracts is qualified to the extent that independent tests of the DoD database were not made. Any errors in the database do not affect the results of our review on the pricing of the contracts.

The universe consisted of 636 contract actions at 124 procurement locations for approximately $145 million. We randomly sampled 43 contracts (Appendixes A and B) for electronic and electrical cables, with a combined value of approximately $11.6 million awarded during 1984 through 1990. We reviewed records at U.S. Army Tank-Automotive Command (TACOM), U.S. Navy Ships Parts Control Center (SPCC), DGSC, Defense Electronics Supply Center (DESC), and UNICOR. During the audit, we reviewed contracts, negotiation memorandums, cost analyses, prime contract proposals, correspondence, actual cost data, and other related documentation from FY 1984 to FY 1991. UNICOR had 55 work orders that tracked the prices, costs and billings for the 54 DoD contracts reviewed. Contract DLA400-89-F-1774 had two UNICOR work orders related to it.

The audit reviewed 13 National Stock Number (NSN) items in Federal Supply Classes 1440 (Electrical/Power Cable Assemblies - guided missile launchers), 1450 (Cable Assembly - guided missile handling equipment), 2590 (Cable Assembly/Wiring Harnesses for Vehicles), 5995 (Electronic and Electrical Cables, Cords, Wire Assemblies - Communications Equipment), and 6150 (Electrical Power Cable Assemblies).

To achieve the audit objectives, we relied in part on computer-processed data contained in the Automated Production and Evaluation Control System of UNICOR. Our review of system controls and the results of data tests showed an error rate that casts doubt on the validity of the data. However, when these data are viewed in context with other available documented evidence of costs, we believe the opinions, conclusions, and recommendations in this report are valid. To develop a procurement history by NSN (Appendix C), we relied in part on computer-processed data contained in Parts-Master purchased by UNICOR from National Standards Association. These data were corrected for any errors based on actual contract data for contracts reviewed. We also limited the scope of our review of UNICOR documentation by not examining intraagency transfers and general and administrative costs reported by the central office. Certified public accounting firms audited UNICOR general and administrative expenses for all fiscal years covered in our

audit. We relied on their audited general and administrative costs.

Audit period, locations, and standards. This financial related audit was performed from September 1990 to June 1991 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. Activities visited are listed in Appendix G.

Internal Controls

Controls assessed. We evaluated internal controls applicable to compliance with laws and regulations and procurement procedures for obtaining and analyzing contract cost or pricing data. Specifically, we reviewed procurement office contract files; actual cost data; Federal Acquisition Regulation (FAR); Defense Federal Acquisition Supplement (DFARS); and Army, Navy, and Defense Logistics Agency regulations. In addition, we interviewed DoD procurement and UNICOR personnel.

Procurement personnel did not have sufficient controls to adequately protect the interests of DoD when determining whether prices quoted by UNICOR were fair and reasonable. We also evaluated the internal controls of UNICOR related to its estimating policies and procedures and its production cost accumulation practices and found internal control weaknesses. We issued a management letter to UNICOR detailing these internal control weaknesses.

Internal control weaknesses. The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Existing internal controls were not followed. The internal control weaknesses included insufficient documentation on contract pricing and noncompliance with regulatory requirements for awarding negotiated contracts. Recommendation 1., if implemented, and changes made during our audit will correct these weaknesses. However, monetary benefits resulting from improved internal controls are not currently quantifiable because they affect contracts not yet awarded to UNICOR. Copies of the final report will be provided to the senior officials responsible for internal controls in the Army, the Navy, and the Defense Logistics Agency.

Prior Audits and Other Reviews

The General Accounting Office; the Office of the Inspector General, DoD; and the Service audit agencies have not audited UNICOR during the last 5 years. However, The Office of the Inspector General, DoD, has an ongoing audit of contract quality

assurance actions resulting from electronic component screening programs (Project No. 0CF-0062), which is scheduled for release within the DoD in draft report form in the fall of 1991. UNICOR is 1 of 92 contractors that we are evaluating for the quality of electronic components provided to DoD.

PART II - FINDING AND RECOMMENDATIONS

CONTRACT PRICING

Prices for 13 NSN items (electronic and electrical cables) purchased from UNICOR exceeded costs and negotiated profit, and UNICOR did not submit accurate, complete, and current cost or pricing data to Government negotiators. This condition occurred because the UNICOR pricing policy was inconsistent with 18 U.S.C. 4124; the UNICOR estimating procedures and practices were not adequate to ensure the development of fair and reasonable prices; and the UNICOR pricing policy and job costing procedures and practices were not followed. In addition, although some contracting officers requested UNICOR to submit cost or pricing data in accordance with FAR subpart 15.8, "Price Negotiation," they did not always require its submission before awarding contracts. Even when such data were received, the contracting officers could not make adequate determinations of the fairness and reasonableness of prices. Thus contracting officers did not adequately protect the interests of DoD when determining whether prices quoted by UNICOR were fair and reasonable. As a result, 48 (89 percent) of the 54 contracts reviewed were overpriced by approximately $1.8 million.

DISCUSSION OF DETAILS

Background

The FAR and the DFARS establish uniform policies and procedures for ensuring that products are procured at fair and reasonable prices. Through contractual terms and conditions, the FAR and DFARS establish both Government and contractor responsibilities. FAR subpart 15.8 requires the submission of cost or pricing data supporting proposals to enable the contracting officer and the contractor to negotiate fair and reasonable prices. It also establishes policies and procedures for contract price negotiations, including procedures and responsibilities for assessing the adequacy of contractor price estimating systems. FAR part 31, "Contract Cost Principles and Procedures," establishes cost principles for determining the allowable, the allocable, and the reasonableness of proposed costs. FAR part 52, "Solicitation Provisions and Contract Clauses," addresses contract clauses that are required to be included in negotiated contracts.

We reconstructed (based on UNICOR records) the actual manufacturing cost of the products sold, the general and administrative rates, the negotiated profit rate, and the additional profit. Additional profit is the profit received above the negotiated profit rate.

UNICOR Pricing

The statutory language in 18 U.S.C. 4124 states that Federal agencies shall purchase goods and services available from UNICOR at not-to-exceed current market prices. However, the language does not state that Federal agencies shall purchase goods and services available from UNICOR at current market prices. We believe that a reasonable price is the sum of reasonable costs to manufacture the product plus a reasonable profit. Reasonable costs plus a reasonable profit may or may not equate to the price expected to be paid if the goods or services were procured from the private sector.

The requirement that UNICOR prices not exceed the market price is not the only factor to be considered by the contracting officer. Under FAR 15.8, the contracting officer must ensure that supplies and services are procured from a responsible source at a fair and reasonable price. If UNICOR prices exceed the sum of reasonable costs to do the work plus a reasonable profit, then the price established would not be considered fair and reasonable.

Contracting officers must also price each contract separately and independently and not use a proposed price reductions under other contracts as an evaluation factor or consider losses or profits realized or anticipated by a contractor under other contracts.

Contracting officers have interpreted the language in 18 U.S.C. 4124 to mean that, if the UNICOR price is within a current market price range, the price should be accepted regardless of actual cost incurred by UNICOR to produce the item. Although the FAR does not define the term "current," the dictionary defines current as "belonging to the present time or now in progress." Based on common usage of the word current, we found that a current market price existed for only 3 of the 13 products purchased or for 3 work orders of the 55 work orders reviewed. However, those three work orders were overpriced by an aggregate of $163,166 (see Appendix C, "Procurement History by NSN" and Appendix A, "Prices of Contracts with Additional Profit by Procurement Location").

In an example showing the ineffectiveness of using a current market price range as the only basis for comparison, on NSN 5995-01-101-8342 (cable assembly), DGSC based the first UNICOR price of $46.59 per unit under contract DLA400-86-F-0013 on the last contract issued to a non-UNICOR contractor at $77 per unit (Appendix C, page 26). The last non-UNICOR contract, however, was determined to be overpriced by at least 200 percent by DGSC Cost and Price Analysis Branch. Although DGSC cost and pricing personnel were aware of the overpricing, the information was not used by DGSC contracting officers. For a subsequent

contract for the same NSN, contract DLA400-87-F-1834, awarded to UNICOR, the contracting officer determined that the quoted price of $46.67 per unit was fair and reasonable because it was less than the last non-UNICOR contract price multiplied by the Producer Price Index. This perpetuation of an already overpriced product resulted in overcharging of $7,615, or 41.4 percent on six contracts, of which $6,991 was voluntarily refunded to DoD. In Appendix A, page 19, we are showing $624 of additional profit that should be refunded ($7,615 minus $6,991). Appendix D shows the contract unit price markup over the actual unit costs for the contracts reviewed.

Contractor Estimating Procedures

UNICOR did not submit current, accurate, or complete cost or pricing data because its estimating procedures and practices were not adequate to ensure compliance with regulatory requirements. FAR 15.811, "Estimating Systems," establishes the requirements for the acceptability of the estimating system of the contractor, which governs its estimating procedures: "An acceptable estimating system benefits both the Government [DoD] and the contractor [UNICOR] by increasing the accuracy and reliability of individual proposals." The results of an acceptable estimating system include limited review required on proposals, more reliable proposals, and expedited negotiations.

When examining the estimating procedures of UNICOR, we, in accordance with FAR requirements, considered the source of the data used in the estimating process and whether or not it was accurate, complete, and current. UNICOR relied on "actual" production costs as recorded on the UNICOR Form 9, "Production Order and Cost Sheet" by factory personnel when developing estimates. However, UNICOR recorded inaccurate production costs on all 55 work orders reviewed. As a result, the UNICOR estimates were based on inaccurate data in all cases. We also found little documentation supporting the rationale behind the UNICOR estimates. After reviewing the procedures for developing estimates for indirect and direct cost elements, we determined that indirect costs were inappropriately estimated as direct costs in 38 (69 percent) of the available estimates for the 55 work orders (Appendixes B and D). In addition, estimates included parts not needed to build the product in 4 (7 percent) of the available estimates for the 55 work orders (Appendixes B and D). We found little evidence of coordination and communication among organizational elements of UNICOR. We did not evaluate the assignment of responsibilities or management support in UNICOR.

General and Administrative rates were consistently estimated at 8 percent when the actual rates were:

Fiscal Year	Percent
1985	4.5
1986	5.9
1987	6.6
1988	7.7
1989	7.1
1990	8.0

These rates were audited by public accounting firms. Despite knowing that the rates were less than 8 percent, UNICOR continued to use 8 percent in arriving at quoted sales prices.

The applied overhead rates, which are predetermined estimated rates, differed significantly from actual overhead rates. The affect of estimated versus actual overhead on actual contract costs, including profit based on the profit rate established at the time of negotiations, is shown in Appendix A.

Contractor Cost Accumulation

FAR part 31 provides procedures for accumulating contract costs. Total cost is defined as the sum of allowable direct and indirect costs allocable to the contract. Any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used. In order for a cost to be allowable, it must first be reasonable. FAR 31.201-3, "Determining Reasonableness," states that a cost is reasonable if it does not exceed that which a prudent person would normally incur. For example, on contract DLA400-89-F-2404, two of the required parts valued at $187.72 were to be Government furnished and were noted as such on the UNICOR estimate. Prior to receiving the Government-furnished material, UNICOR used available inventory to start work on the contract. According to UNICOR personnel, the Government-furnished material was used on another contract or replaced inventory. UNICOR, however, inappropriately charged the contract for the cost of the parts, thus potentially inflating the next estimate.

The UNICOR Accounting Manual Section 8506, paragraph 104, stresses, "... matching of costs to the applicable cost objective and accounting period, uniformity among similar factories, consistency over a period of time, and verifiability of information accumulated." These requirements were not applied. Undocumented movement of material among jobs occurred on all 55 work orders reviewed, and reported production costs were inaccurate on all 55 work orders reviewed. After reviewing the procedures for charging indirect and direct cost elements, we determined that indirect costs were inappropriately charged as direct costs on 17 of 55 work orders. At one UNICOR facility,

indirect costs were charged as direct costs on 14 of the 20 work orders reviewed. Reclassifying them as indirect costs affected actual overhead rates in 26 of the 61 months under review. At another UNICOR facility, packing pallets totaling $5,325 were incorrectly charged directly to contract DLA400-88-F-0594. The failure of UNICOR to follow the instructions in its own accounting manual adversely affected quotations provided to DoD and negotiations held with DoD.

The weaknesses in the UNICOR contract price estimating system and the UNICOR contract cost accumulation policies and procedures were detailed in a management letter issued to UNICOR. These same weaknesses led to UNICOR incurring a loss of $288,047 on 5 contracts valued at $786,133 (Appendix B). There was one contract valued at $1.5 million that was correctly priced.

Negotiation of Procurements From UNICOR

FAR part 15 prescribes policies and procedures governing contracting for supplies and services by negotiation. Negotiation is defined as "... contracting through the use of either competitive or other-than-competitive proposals and discussions. Any contract awarded without using sealed bidding procedures is a negotiated contract." Negotiation includes the receipt of proposals from offerors, permits bargaining, and usually provides offerors an opportunity to revise their offers before award of a contract. In order to effectively negotiate a fair and reasonable price, an exchange of information must take place so that both sides have an equal bargaining position based on informational parity. When informational parity does not exist, overpricing can occur.

In order to provide informational parity, a cost breakdown is needed. A cost breakdown is an itemized estimate of costs to manufacture the product, such as material charges, labor, overhead, general and administrative costs, and expected profit. A cost breakdown can be based either on the actual costs incurred under a previous contract or on the current estimate of potential costs to be incurred during production. For example, on DGSC contract DLA400-89-F-0472, the contracting officer requested a cost breakdown, but did not receive it. In the absence of a cost breakdown, the contracting officer assumed that the previous price of $585.49 per unit DGSC paid for the product, on contract DLA400-88-F-1348, was fair and reasonable. The contracting officer then used that price as a beginning point of reference. However, after reconstructing actual costs on the previous contract, DLA400-88-F-1348, we discovered that UNICOR overcharged DGSC $135.49 per unit for a total of $200,796, or

approximately 23 percent. Additionally, on the follow-on contract, DLA400-89-F-0472, UNICOR overcharged DGSC $12,551, or approximately 15 percent. Had UNICOR provided the requested cost breakdown, DGSC would have had information for determining a fair and reasonable price.

Exemption From Normal Contracting Methods

Contracting officers believed that UNICOR was exempt from normal contracting methods used during competitive procurements because Federal departments and agencies are mandated to buy products from UNICOR before issuing competitive proposals to the private sector. This mandate should not influence the contracting methods used to evaluate the price offered, prevent determining whether or not the price is fair and reasonable, and preclude incorporating standard contract clauses. During negotiations on TACOM contract DAAE07-89-F-0017, UNICOR personnel informed TACOM that cost data on the prior contract, DAAE07-87-F-0107, showed that the contract was completed at a loss to UNICOR. Initial documentation available to UNICOR Headquarters on contract DAAE07-87-F-0107 showed that this contract was not manufactured at a loss. However, TACOM did not obtain a detailed cost breakdown. After reviewing the actual contract costs, we found that contract DAAE07-87-F-0107 was overpriced by $27,692, or approximately 11 percent. In addition, contract DAAE07-89-F-0017 was overpriced by $25,984, or approximately 12 percent.

An SPCC internal memorandum states, "Unless the history or item description indicates otherwise, a certified current market price from UNICOR should be accepted as a fair and reasonable price." During negotiations, it is expected that the contracting officer will seek independent verification of price reasonableness rather than relying solely on contractor information. On contract N00104-88-F-0577 for $2,321,023, the SPCC contracting officer accepted the proposed price without obtaining Defense Contract Audit Agency (DCAA) audit support, performing a preaward survey, or requesting cost or pricing data. The contracting officer justified the price by comparing it to prices paid on contracts issued approximately 4 years prior to the proposed award. One of the prior contracts, N00104-84-F-0627 was issued to UNICOR. Because normal pricing techniques were not applied, contract N00104-88-F-0577 was overpriced by $226,260, or approximately 10 percent. In addition, the UNICOR contract, N00104-84-F-0627, used for a comparison to current market price, was also overpriced by $145,765, or approximately 32 percent.

UNICOR Prices Are Negotiable

Prices offered by UNICOR can and should be negotiated to arrive at a fair and reasonable price. When prices are accepted without negotiation, the opportunity for overpricing exists. For example, DESC has been buying cable assemblies,

NSN 1440-00-118-1922, exclusively from UNICOR since 1972. On the most recent contract, DLA900-89-F-0533, DESC performed "... a very limited market survey with three companies ..." and obtained estimates ranging from $300 to $700 per unit. DESC, without negotiation, then accepted the UNICOR offer of $465.64 per unit. Contract DLA900-89-F-0533 was overpriced by $102.66 per unit for a total of $20,224, or 22 percent. Furthermore, the other four contracts for the same item awarded since 1984 were overpriced in an aggregate of $213,013, or approximately 50 percent of the combined total contract values.

In order to negotiate effectively, a contracting officer needs sufficient cost or pricing data to perform a cost or price analysis, which ultimately enables DoD and the contractor to negotiate fair and reasonable prices. TACOM, in its Standard Operating Procedure 715-146, Paragraph 10, states that UNICOR is exempt from the requirement to submit cost or pricing data, based on FAR 15.804-3(a)(3), "Exemption From or Waiver of Submission of Certified Cost or Pricing Data." FAR 15.804-3(a)(3) states that certified cost or pricing data need not be submitted when prices are set by law or regulation. This FAR provision does not exempt contractors or UNICOR from submitting cost or pricing data. On contract DAAE07-89-F-0076, TACOM did not obtain submission of detailed cost or pricing data. After reviewing actual contract costs, we found that the contract was overpriced by $20,800, or 24 percent. TACOM has revised its Standard Operating Procedure as a result of this audit. A list of other common misconceptions on procuring items from UNICOR is listed at Appendix E.

Cost or Price Analysis

Contracting officers must exercise good judgment in determining how much and what data to collect and analyze to decide whether a price is fair and reasonable. DoD procurement activities assumed incorrectly that a thorough cost or price analysis and DCAA audit support did not need to be requested when procuring from UNICOR. A cost or price analysis and a request for DCAA audit support should be made when procuring from UNICOR to ensure that a fair and reasonable price is achieved. Failure to perform a thorough analysis contributed to the payment of excessive prices on 48 of the 54 contracts reviewed.

Pricing Support

We discussed procurements from UNICOR with the DCAA. We were advised that the DCAA was never previously requested to provide field pricing support for a negotiation with UNICOR. We were also advised that the DCAA was not sure of its duty to provide such support because UNICOR is an organizational element of the Department of Justice and a wholly owned Government corporation, although UNICOR is an entity incorporated in the District of Columbia. We believe that the DCAA should obtain legal guidance

on its mission to provide pricing support to contracting officers when UNICOR is the potential contractor.

Certified Cost or Pricing Data

FAR 15.804.3 states that the contracting officer shall require submission of certified cost or pricing data and the inclusion of clauses 52.215-22, "Price Reduction for Defective Cost or Pricing Data," and 52.215-24, "Subcontractor Cost or Pricing Data," in the contract unless the contracting officer determines that prices are based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation.

UNICOR prices are not based on adequate price competition because UNICOR is a mandatory source of supply. UNICOR does not have established catalog or market prices of commercial items sold in substantial quantities to the general public because UNICOR is expressly prohibited from selling its goods and services outside the Federal Government. To receive an exemption based on established prices set by law or regulation, UNICOR must ordinarily claim the exemption under a Standard Form 1412, "Claim for Exemption of Submission of Certified Cost or Pricing Data," when the amount exceeds the threshold. We could find no evidence that UNICOR had ever requested or had ever been granted an exemption or waiver from the submission of certified cost and pricing data.

If an item qualifies for exemption from the requirement for submission of certified cost or pricing data, the contracting officer shall make a price analysis to determine reasonableness of the price and any need for further negotiations.

TACOM contracting officers incorrectly believed that the General Accounting Office (GAO) audits UNICOR rates on a regular basis. GAO has not audited UNICOR since 1985, GAO/GGD-86-6, "UNICOR Products: Federal Prison Industries Can Further Ensure Customer Satisfaction," dated November 1, 1985. During that audit, GAO did not approve or disapprove labor and overhead rates used by UNICOR. According to the internal pricing policy of UNICOR, each division is responsible for setting prices for the products it sells.

As a result of not obtaining certified cost or pricing data, 12 of 16 contracts valued at $100,000 or above were overpriced by approximately $1.6 million, for which we are recommending that a voluntary refund be requested. We also believe DoD should request a refund of $200,000 for the other 38 contracts with UNICOR that were below the $100,000 threshold for certified cost or pricing data.

Conclusion

Many of the problems identified would not exist if contracting officers had specific guidance related to procurements from UNICOR. Necessary guidance should address the need to: request accurate, complete, and current cost or pricing data; request certified cost and pricing data; include appropriate defective pricing clauses in contracts or request waivers to the requirement, and request appropriate field pricing support. There is also a need to include guidance on conducting procurements with UNICOR in the appropriate DoD training curriculums. On July 11, 1991, DLA issued an interim memorandum providing additional instructions to their buying offices, pending more specific guidance. UNICOR does have operational difficulties and limitations posed by their unique mission and the need for UNICOR to achieve sufficient earnings to permit expansion of factories for the incorporation of an expanding prison population. Because of the lack of knowledge by both DoD contracting officers and UNICOR on how to conduct negotiations for contracts under the unique mandate accorded UNICOR we believe there is a need for coordination between senior DoD procurement and UNICOR officials. The coordination would help establish a profit policy to satisfy the mission of UNICOR that is acceptable to DoD.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Director of Defense Procurement; Assistant Secretaries of the Army (Research, Development, and Acquisition) and the Navy (Research, Development, and Acquisition); and the Director, Defense Logistics Agency:

a. Provide guidance to contracting officers on conducting purchases from UNICOR. The guidance should include requirements for contracting officers to:

(1) Request and obtain from UNICOR accurate, complete, and current cost or pricing data sufficient to determine fair and reasonable prices and to negotiate procurements directed to UNICOR.

(2) Request and obtain from UNICOR certified cost and pricing data in accordance with Federal Acquisition Regulation 15.804 "Cost or Pricing Data," and to include the appropriate defective pricing clauses or formally request waivers from the requirement.

(3) Request field pricing support in accordance with Federal Acquisition Regulation 15.805.5 "Field Pricing Support."

b. Include appropriate instruction on conducting procurements from UNICOR in the acquisition training curriculum.

2. We recommend that the Director of Defense Procurement coordinate with the Federal Prison Industries on the parameters of reasonableness for UNICOR profits on individual contracts.

3. We recommend that the Director, Defense Contract Audit Agency obtain a legal opinion on whether they can provide contract audit support for UNICOR proposals and contracts.

4. We recommend that the Commander, Tank-Automotive Command request a voluntary refund of $81,349 for contracts listed in Appendix A, page 17, and review other contracts with UNICOR for potential overpricing.

5. We recommend that the Commander, Navy Ships Parts Control Center request a voluntary refund of $372,025 for contracts listed in Appendix A, page 18, and review other contracts with UNICOR for potential overpricing.

6. We recommend that the Commander, Defense Electronics Supply Center request a voluntary refund of $233,237 for contracts listed in Appendix A, page 18, and review other contracts with UNICOR for potential overpricing.

7. We recommend that the Commander, Defense General Supply Center request a voluntary refund of $1,143,170 for contracts listed in Appendix A, pages 19 to 21, and review other contracts with UNICOR for potential overpricing.

MANAGEMENT COMMENTS

The Assistant Secretary of the Army (Research, Development and Acquisition) stated that TACOM requested a refund from UNICOR on August 26, 1991, and will review other contracts as needed.

The Chief Executive Officer, Federal Prison Industries, Inc., provided comments that are included in full in Part IV and are synopsized in Appendix I.

PART III - ADDITIONAL INFORMATION

APPENDIX A - Prices of Contracts with Additional Profit By Procurement Location

APPENDIX B - Prices of Contracts with Losses or Reasonable Profit by Procurement Locations

APPENDIX C - Procurement History by NSN

APPENDIX D - Unit Price Markup

APPENDIX E - Common Misconceptions on Procuring Items From UNICOR

APPENDIX F - Summary of Potential Monetary And Other Benefits Resulting From Audit

APPENDIX G - Activities Visited or Contacted

APPENDIX H - Final Report Distribution

APPENDIX I - Detailed Audit Responses To Federal Prison Industries Comments

APPENDIX A: PRICES OF CONTRACTS WITH ADDITIONAL PROFIT BY PROCUREMENT LOCATION

U.S. ARMY TANK-AUTOMOTIVE COMMAND

CABLE ASSEMBLY
NSN # 6150-01-119-4117
DAAE07-

CONTRACT NUMBER	CONTRACT VALUE	ACTUAL COST W/ 1/ APPLIED O/H	ACTUAL COST W/ 1/ ACTUAL O/H	ADDITIONAL 1/ PROFIT W/ APPLIED O/H	ADDITIONAL 1/ PROFIT W/ ACTUAL O/H	ADDITIONAL 2/ PROFIT RANGE (PERCENT)
89-F-0076	$ 87,739.06	$ 64,174.96	$ 66,938.99	$23,564.10	$20,800.07	27-24

CABLE ASSEMBLY
NSN # 2590-01-119-4117

87-F-0063	47,302.50	40,268.75	40,430.00	7,033.75	6,872.50	15-15

WIRING HARNESS, BRAN
NSN # 2590-01-083-5724

87-F-0107	243,608.97	220,890.96	215,916.88	22,718.01	27,692.09	9-11
89-F-0017	220,263.68	199,244.80	194,279.68	21,018.88	25,984.00	10-12
	$463,872.65	$420,135.76	$410,196.56	$43,736.89	$53,676.09	
	$598,914.21	$524,579.47	$517,565.55	$74,334.74	$81,348.66	

1/ Actual Cost with Applied Overhead and Actual Cost with Actual Overhead include profit based on the profit rate established at the time of negotiations.
2/ The Additional Profit Range is the percentage of profit received above the profit rate agreed to at the time of negotiations.

APPENDIX A: PRICES OF CONTRACTS WITH ADDITIONAL PROFIT BY PROCUREMENT LOCATION (Continued)

U.S. NAVY SHIPS PARTS CONTROL CENTER

CABLE ASSEMBLY, UMBI
NSN # 1450-01-021-6112
N00104-

CONTRACT NUMBER	CONTRACT VALUE	ACTUAL COST W/ APPLIED O/H 1/	ACTUAL COST W/ ACTUAL O/H 1/	ADDITIONAL PROFIT W/ APPLIED O/H 1/	ADDITIONAL PROFIT W/ ACTUAL O/H 1/	ADDITIONAL PROFIT RANGE (PERCENT) 2/
84-F-0627	$ 453,386.95	$ 328,735.31	$ 307,622.24	$124,651.64	$145,764.71	27-32
88-F-0577	2,321,022.60	2,116,684.70	2,094,762.54	204,337.90	226,260.06	9-10
	$2,774,409.55	$2,445,420.01	$2,402,384.78	$328,989.54	$372,024.77	

DEFENSE ELECTRONICS SUPPLY CENTER

CABLE ASSEMBLY, POWER, ELECTRICAL
NSN # 1440-00-118-1922
DLA900-

CONTRACT NUMBER	CONTRACT VALUE	ACTUAL COST W/ APPLIED O/H 1/	ACTUAL COST W/ ACTUAL O/H 1/	ADDITIONAL PROFIT W/ APPLIED O/H 1/	ADDITIONAL PROFIT W/ ACTUAL O/H 1/	ADDITIONAL PROFIT RANGE (PERCENT) 2/
84-F-0899	$ 27,961.80	$ 15,241.82	$ 16,242.90	$ 12,719.98	$ 11,718.90	45-42
85-F-0616	97,730.94	56,267.67	56,377.17	41,463.27	41,353.77	42-42
85-F-0803	152,174.66	65,720.06	67,702.14	86,454.60	84,472.52	57-56
88-F-0935	147,504.30	74,618.70	72,036.54	72,885.60	75,467.76	49-51
89-F-0533	91,731.08	66,786.94	71,507.06	24,944.14	20,224.02	27-22
	$517,102.78	$278,635.19	$283,865.81	$238,467.59	$233,236.97	

1/ Actual Cost with Applied Overhead and Actual Cost with Actual Overhead include profit based on the profit rate established at the time of negotiations.
2/ The Additional Profit Range is the percentage of profit received above the profit rate agreed to at the time of negotiations.

APPENDIX A: PRICES OF CONTRACTS WITH ADDITIONAL PROFIT BY PROCUREMENT LOCATION (Continued)

DEFENSE GENERAL SUPPLY CENTER

HOTLINE ALLEGATION, AFTER REFUND

CABLE ASSEMBLY
NSN # 5995-01-101-8342
DLA400-

CONTRACT NUMBER	CONTRACT VALUE	ACTUAL COST W/ 1/ APPLIED O/H	ACTUAL COST W/ 1/ ACTUAL O/H	ADDITIONAL 1/ PROFIT W/ APPLIED O/H	ADDITIONAL 1/ PROFIT W/ ACTUAL O/H	ADDITIONAL 2/ PROFIT RANGE (PERCENT)
86-F-0013	$ 904.19	$ 245.18	$ 259.53	$ 659.01	$ 644.66	73-71
86-F-1514	1,147.28	360.64	360.64	786.64	786.64	69-69
87-F-0969	1,072.00	1,385.00	1,670.00	(313.00)	(598.00)	
87-F-1834	1,286.40	2,458.20	2,609.40	(1,171.80)	(1,323.00)	
89-F-1145	3,430.40	3,670.40	3,296.00	(240.00)	134.40	0- 4
90-F-1356	3,559.04	2,260.92	2,579.64	1,298.12	979.40	37-28
	$11,399.31	$10,380.34	$10,775.21	$1,018.97	$ 624.10	

CABLE ASSEMBLY, SPEC PURP, ELECTRICAL
NSN # 5995-01-027-3320

87-F-0695	$ 3,424.20	$ 3,569.80	$ 3,937.70	$ (145.60)	$ (513.50)	
87-F-1496	3,991.50	3,019.50	3,232.50	972.00	759.00	24-19
87-F-2878	2,746.15	1,885.00	1,796.00	861.15	950.15	31-35
88-F-0446	4,198.50	3,114.00	3,343.50	1,084.50	855.00	26-20
89-F-1146	3,342.50	4,691.25	4,168.75	(1,348.75)	(826.25)	
	$17,702.85	$16,279.55	$16,478.45	$1,423.30	$1,224.40	

1/ Actual Cost with Applied Overhead and Actual Cost with Actual Overhead include profit based on the profit rate established at the time of negotiations.
2/ The Additional Profit Range is the percentage of profit received above the profit rate agreed to at the time of negotiations.

APPENDIX A: PRICES OF CONTRACTS WITH ADDITIONAL PROFIT BY PROCUREMENT OFFICE (Continued)

DEFENSE GENERAL SUPPLY CENTER

CABLE ASSEMBLY, RF
NSN # 5995-01-095-9004
DLA400-

CONTRACT NUMBER	CONTRACT VALUE	ACTUAL COST W/ 1/ APPLIED O/H	ACTUAL COST W/ 1/ ACTUAL O/H	ADDITIONAL 1/ PROFIT W/ APPLIED O/H	ADDITIONAL 1/ PROFIT W/ ACTUAL O/H	ADDITIONAL 2/ PROFIT RANGE (PERCENT)
86-F-3515	$ 7,930.00	$ 7,043.06	$ 6,225.66	$ 886.94	$ 1,704.34	11-21
87-F-3327	3,256.54	1,747.34	1,928.64	1,509.20	1,327.90	46-41
89-F-2306	29,820.99	19,898.82	19,510.65	9,922.17	10,310.34	33-35
	$ 41,007.53	$ 28,689.22	$ 27,664.95	$ 12,318.31	$ 13,342.58	

CABLE ASSEMBLY, SPECIAL PURPOSE
NSN # 5995-00-889-0911

90-F-0045	$ 25,852.88	$ 23,759.94	$ 23,810.65	$ 2,092.94	$ 2,042.23	8- 8
89-F-1774 3/	39,004.00	33,418.00	33,299.00	5,586.00	5,705.00	14-15
	$ 64,856.88	$ 57,177.94	$ 57,109.65	$ 7,678.94	$ 7,747.23	

CABLE ASSEMBLY, POWER, ELECTRICAL
NSN # 6150-01-220-5587

87-F-2857 4/	$ 796,214.72	$ 744,571.52	$ 750,450.40	$ 51,643.20	$ 45,764.32	7- 6
87-F-3343	89,721.24	82,057.20	83,274.15	7,664.04	6,447.09	9- 7
88-F-0067	67,658.64	63,652.50	64,491.54	4,006.14	3,167.10	6- 5
88-F-0595	1,171,477.98	1,059,614.46	1,069,777.44	111,863.52	101,700.54	10- 9
88-F-1348	867,696.18	666,292.38	666,900.00	201,403.80	200,796.18	23-23
89-F-0472	83,340.80	69,324.64	70,789.36	14,016.16	12,551.44	17-15
90-F-0413	494,976.14	334,420.80	332,188.10	160,555.34	162,788.04	32-33
	$3,571,085.70	$3,019,933.50	$3,037,870.99	$551,152.20	$533,214.71	

1/ Actual Cost with Applied Overhead and Actual Cost with Actual Overhead include profit based on the profit rate established at the time of negotiations.
2/ The Additional Profit Range is the percentage of profit received above the profit rate agreed to at the time of negotiations.
3/ Contract value excludes $600 for first article test report.
4/ Contract value excludes $260 for first article test report.

APPENDIX A: PRICES OF CONTRACTS WITH ADDITIONAL PROFIT BY PROCUREMENT LOCATION (Continued)

DEFENSE GENERAL SUPPLY CENTER
CABLE ASSEMBLY, RF
NSN # 5995-00-823-2935
DLA400-

WORK ORDER	CONTRACT VALUE	ACTUAL COST W/1/ APPLIED O/H	ACTUAL COST W/1/ ACTUAL O/H	ADDITIONAL1/ PROFIT W APPLIED O/H	ADDITIONAL1/ PROFIT W ACTUAL O/H	ADDITIONAL2/ PROFIT RANGE (PERCENT)
85-F-0553	$ 7,305.90	$ 4,586.40	$ 4,645.20	$ 2,719.50	$ 2,660.70	37-36
86-F-2730	14,540.40	13,242.15	12,434.35	1,298.25	2,106.05	9-14
88-F-0222	14,042.28	9,453.12	10,497.36	4,589.16	3,544.92	33-25
88-F-1828	36,509.40	24,474.82	24,812.87	12,034.58	11,696.53	33-32
89-F-0574	10,684.80	7,155.00	7,975.44	3,529.80	2,709.36	33-25
89-F-1403	27,614.60	18,969.60	18,031.00	8,645.00	9,583.60	31-35
90-F-0419	16,281.14	14,456.03	13,500.02	1.825.11	2,781.12	11-17
	$ 126,978.52	$ 92,337.12	$ 91,896.24	$ 34,641.40	$ 35,082.28	

CABLE ASSEMBLY, RF
NSN # 6150-01-220-5588

87-F-3342	5/$ 54,427.23	$ 53,584.96	$ 54,304.25	$ 842.27	$ 122.98	2- 0
88-F-0040	60,897.60	60,321.60	60,635.20	576.00	262.40	1- 0
88-F-0594	2,116,639.80	1,952,122.50	1,973,205.90	164,517.30	143,433.90	8- 7
88-F-1349	1,681,198.00	1,284,248.00	1,290,368.00	396,950.00	390,830.00	24-23
89-F-2404	5,785.44	3,628.08	3,575.64	2,157.36	2,209.80	37-38
90-F-0024	32,435.10	22,092.30	21,911.40	10,342.80	10,523.70	32-32
	$3,951,383.17	$3,375,997.44	$3,404,000.39	$ 575,385.73	$ 547,382.78	

CABLE ASSEMBLY, SPECIAL PURPOSE, ELECTRICAL
NSN #5995-01-080-7920

85-F-2428	6/$ 3,651.00	$ 2,853.00	$ 3,090.00	$ 798.00	$ 561.00	22-15
89-F-1774	20,156.85	16,187.85	16,165.80	3,969.00	3,991.05	20-20
	$ 23,807.85	$ 19,040.85	$ 19,255.80	$ 4,767.00	$4,552.05	
	$7,808,221.81	$6,619,835.96	$6,665,051.68	$1,188,385.85	$1,143,170.13	

1/ Actual Cost with Applied Overhead and Actual Cost with Actual Overhead include profit based on the profit rate established at the time of negotiations.
2/ The Additional Profit Range is the percentage of profit received above the profit rate agreed to at the time of negotiations.
5/ Contract value excludes $260 for first article test report.
6/ Contract value excludes $220 for first article test report.

APPENDIX B: PRICES OF CONTRACTS WITH LOSSES OR REASONABLE PROFIT BY PROCUREMENT LOCATION

U.S. ARMY TANK-AUTOMOTIVE COMMAND

CABLE FOR VEHICLES
NSN # 2590-01-144-8899
DAAE07-

CONTRACT NUMBER	ACTUAL COST	CONTRACT VALUE	LOSS
86-F-0004 1/	$ 320,946.50 2/	$ 148,869.47	$172,077.03 3/
87-F-0025 1/	$ 242,908.08 2/	$ 153,334.44	$ 89,573.64
89-F-0013 1/	$ 174,179.00 2/	$ 154,330.00	$ 19,849.00

DEFENSE GENERAL SUPPLY CENTER

CABLE ASSEMBLY, RF
NSN # 5995-00-823-2935
DLA400-

85-F-1109 4/	$ 30,588.80 2/	$ 25,128.32	$ 5,460.48
89-F-0998	$ 17,510.48 2/	$ 16,423.42	$ 1,087.06

CABLE ASSEMBLY, RF
NSN # 6150-01-220-5588

87-F-3087 5/	$1,541,470.50 6/	$1,541,470.50	$ 0

1/ UNICOR estimated overhead items as direct items.
2/ Actual cost includes direct materials, direct labor, factory overhead, and general and administrative costs.
3/ Quality Deficiency Report resulting in rework contributed to the loss on this contract.
4/ UNICOR estimate included parts that were not needed to manufacture the product.
5/ Contract value excludes $260 for first article testing.
6/ Actual cost includes direct materials, direct labor, factory overhead, general and administrative costs, and 10 percent negotiated profit.

APPENDIX C: PROCUREMENT HISTORY BY NATIONAL STOCK NUMBER

CONTRACT NUMBER	AWARD DATE	UNIT PRICE	QUANTITY 1/	CURRENT UNICOR/ NOT UNICOR	MARKET/ NO MARKET
		NSN: 6150-01-119-4117/ 2590-01-119-4117 CABLE ASSEMBLY			
DAAE07-89-F-0076 2/	Aug. 25, 1989	$ 383.14	229	UNICOR	NO MARKET
DAAE07-87-F-0063 2/	Jan. 22, 1987	$ 378.42	125	UNICOR	NO MARKET
DAAE07-81-G-0003	Sep. 30, 1982	$ 687.44	20	NOT UNICOR	NO MARKET
		NSN: 2590-01-083-5724 WIRING HARNESS, BRANCHED			
DAAE07-89-F-0017 2/	Jan. 27, 1989	$1,720.81	127	UNICOR	NO MARKET
DAAE07-87-F-0107 2/	Apr. 09, 1987	$1,817.9774	134	UNICOR	NO MARKET
DAAE07-81-G-0003	Jan. 21, 1983	$1,965.60	224	NOT UNICOR	CURRENT MARKET
DAAE07-81-G-0003	Nov. 03, 1982	$ 541.72	109	NOT UNICOR	CURRENT MARKET
DAAE07-81-G-0003	Nov. 03, 1982	$1,979.70	37	NOT UNICOR	CURRENT MARKET
DAAE07-79-C-0149	Feb. 21, 1979	$1,989.75	69	NOT UNICOR	CURRENT MARKET
		NSN: 1450-01-021-6112 CABLE ASSEMBLY, UMBI			
N00104-88-F-0577 2/	Apr. 26, 1988	$ 834.30	2782	UNICOR	NO MARKET
N00104-86-C-5382	Aug. 05, 1986	$1,096.84	130	NOT UNICOR	CURRENT MARKET
N00104-85-G-0367	Sep. 12, 1985	$ 840.18	1746	NOT UNICOR	CURRENT MARKET
N00104-85-G-0367	Sep. 08, 1985	$1,580.93	27	NOT UNICOR	CURRENT MARKET
N00104-83-G-0006	Aug. 31, 1984	$ 873.62	3278	NOT UNICOR	CURRENT MARKET
N00104-84-F-0627 2/	May 16, 1984	$ 970.85	467	UNICOR	CURRENT MARKET 3/
N00104-84-W-SS56	Apr. 02, 1984	$1,385.57	3	NOT UNICOR	CURRENT MARKET
N00104-84-C-3301	Dec. 27, 1983	$1,385.57	13	NOT UNICOR	CURRENT MARKET
N00104-82-C-3685	May 10, 1982	$ 650.41	1870	NOT UNICOR	CURRENT MARKET
N00104-82-C-1261	May 03, 1982	$1,195.13	29	NOT UNICOR	CURRENT MARKET
N00104-79-C-4957	Dec. 08, 1978	$ 400.63	1578	NOT UNICOR	CURRENT MARKET

1/ Quantity is the procurement quantity, actual quantity produced and shipped may vary.
2/ Contract included in audit and determined to be overpriced.
3/ Current market price available for use in negotiating the price.

APPENDIX C: PROCUREMENT HISTORY BY NATIONAL STOCK NUMBER (Continued)

CONTRACT NUMBER	AWARD DATE	UNIT PRICE	QUANTITY 1/	CURRENT UNICOR/ NOT UNICOR	MARKET/ NO MARKET
		NSN: 1440-00-118-1922 CABLE ASSEMBLY, POWER, ELECTRICAL			
DLA900-89-F-0533 2/	Nov. 17, 1988	$465.64	197	UNICOR	NO MARKET
DLA900-88-F-0935 2/	July 01, 1988	$463.85	319	UNICOR	NO MARKET
DLA900-85-F-0803 2/	Mar. 18, 1985	$446.26	341	UNICOR	NO MARKET
DLA900-85-F-0616 2/	Dec. 17, 1984	$446.26	219	UNICOR	NO MARKET
DLA900-84-F-0899 2/	Apr. 20, 1984	$482.10	58	UNICOR	NO MARKET
DAAH01-78-F-0508	Aug. 04, 1978	$250.50	265	UNICOR	NO MARKET
DAAH01-77-F-0416	Aug. 18, 1977	$253.45	210	UNICOR	NO MARKET
DAAH01-76-F-0021	Aug. 27, 1975	$250.15	158	UNICOR	NO MARKET
DAAH01-75-F-0396	May 29, 1975	$259.70	65	UNICOR	NO MARKET
DAAH01-74-F-0253	Mar. 08, 1974	$207.70	25	UNICOR	NO MARKET
DAAH01-74-F-0157	Nov. 20, 1973	$198.35	45	UNICOR	NO MARKET
DAAH01-74-F-0013	July 11, 1973	$198.35	110	UNICOR	NO MARKET
DAAH01-73-F-0063	Aug. 11, 1972	$180.80	46	UNICOR	NO MARKET
DAAH01-72-F-0101	Apr. 24, 1972	$180.80	41	UNICOR	NO MARKET
		NSN: 5995-01-101-8342 CABLE ASSEMBLY			
DLA400-90-F-1356 2/	Apr. 12, 1990	$ 35.01	159	UNICOR	NO MARKET
DLA400-89-F-1145 2/	Mar. 22, 1989	$ 34.70	160	UNICOR	NO MARKET
DLA400-87-F-1834 2/	Apr. 29, 1987	$ 46.67	60	UNICOR	NO MARKET
DLA400-87-F-0969 2/	Feb. 03, 1987	$ 46.67	50	UNICOR	NO MARKET
DLA400-86-F-1514 2/	Mar. 03, 1986	$ 45.62	45	UNICOR	NO MARKET
DLA400-86-F-0013 2/	Oct. 01, 1985	$ 46.59	40	UNICOR	NO MARKET
DLA400-84-M-1026	Oct. 11, 1983	$ 77.00 4/	81	NOT UNICOR	CURRENT MARKET
F33657-78-C-0104	Jan. 02, 1978	$ 67.89	1	NOT UNICOR	CURRENT MARKET
		NSN: 5995-01-027-3320 CABLE ASSEMBLY, SPECIAL PURPOSE, ELECTRICAL			
DLA400-89-F-1146 2/	Mar. 17, 1989	$ 51.47	125	UNICOR	NO MARKET
DLA400-89-F-0446 2/	Nov. 19, 1987	$ 52.72	150	UNICOR	NO MARKET
DLA400-87-F-2878 2/	Aug. 10, 1987	$ 52.21	100	UNICOR	NO MARKET
DLA400-87-F-1496 2/	Mar. 23, 1987	$ 51.34	150	UNICOR	NO MARKET
DLA400-87-F-0695 2/	Dec. 20, 1986	$ 51.07	130	UNICOR	NO MARKET
DLA400-82-M-L758	Jan. 31, 1982	$ 50.00	89	NOT UNICOR	CURRENT MARKET

1/ Quantity is the procurement quantity, actual quantity produced and shipped may vary.
2/ Contract included in audit and determined to be overpriced.
4/ Determined by Defense General Supply Center to be overpriced by at least 200 percent.

APPENDIX C: PROCUREMENT HISTORY BY NATIONAL STOCK NUMBER (Continued)

CONTRACT NUMBER	AWARD DATE	UNIT PRICE	QUANTITY 1/	CURRENT UNICOR/ NOT UNICOR	MARKET/ NO MARKET
		NSN: 5995-01-095-9004 CABLE ASSEMBLY, RADIO FREQUENCY			
DLA400-89-F-2306 2/	Aug. 11, 1989	$ 43.79	681	UNICOR	NO MARKET
DLA400-87-F-3327 2/	Sep. 23, 1987	$ 66.46	49	UNICOR	NO MARKET
DLA400-86-F-3515 2/	Aug. 29, 1986	$ 65.00	135	UNICOR	NO MARKET
N00383-84-G-4906	July 13, 1985	$202.44	20	NOT UNICOR	CURRENT MARKET
N00383-84-G-4906	June 07, 1985	$190.24	1	NOT UNICOR	CURRENT MARKET
N00303-84-G-4906	May 01, 1985	$190.24	1	NOT UNICOR	CURRENT MARKET
DLA400-85-W-T035	Oct. 10, 1984	$190.87	2	NOT UNICOR	CURRENT MARKET
		NSN: 5995-00-889-0911 CABLE ASSEMBLY, SPECIAL PURPOSE, ELECTRICAL			
DLA400-90-F-2414	Sep. 24, 1990	$ 57.89	481	UNICOR	NO MARKET
DLA400-90-F-0045 2/	Oct. 04, 1989	$ 56.08	460	UNICOR	NO MARKET
DLA400-89-F-1774 2/	May 31, 1989	$ 55.72	700	UNICOR	CURRENT MARKET 3/
DLA400-88-M-T503	Aug. 01, 1988	$ 70.00	87	NOT UNICOR	CURRENT MARKET
DLA400-88-M-J233	May 08, 1988	$ 85.55	65	NOT UNICOR	CURRENT MARKET
DLA400-88-M-H211	Apr. 16, 1988	$ 70.00	20	NOT UNICOR	CURRENT MARKET
DLA400-88-M-8399	Jan. 12, 1988	$ 72.00	66	NOT UNICOR	CURRENT MARKET
DLA400-87-M-R203	May 19, 1987	$ 94.30	41	NOT UNICOR	CURRENT MARKET
DLA400-87-M-0761	Oct. 13, 1986	$106.92	8	NOT UNICOR	CURRENT MARKET
DLA400-85-M-N116	Apr. 02, 1985	$ 98.70	25	NOT UNICOR	CURRENT MARKET
DLA400-84-M-Y887	July 31, 1984	$160.00	4	NOT UNICOR	CURRENT MARKET
DLA400-84-M-V224	June 30, 1984	$110.00	10	NOT UNICOR	CURRENT MARKET
DLA400-84-M-E626	Mar. 20, 1984	$170.00	2	NOT UNICOR	CURRENT MARKET
		NSN: 6150-01-220-5587 CABLE ASSEMBLY, POWER, ELECTRICAL			
DLA400-90-F-0413 2/	Oct. 31, 1989	$920.03	516	UNICOR	NO MARKET
DLA400-89-F-0472 2/	Dec. 02, 1988	$612.80	131	UNICOR	NO MARKET
DLA400-88-F-1348 2/	Mar. 16, 1988	$585.49	1482	UNICOR	NO MARKET
DLA400-88-F-0595 2/	Dec. 07, 1987	$496.81	2352	UNICOR	NO MARKET
DLA400-88-F-0067 2/	Oct. 13, 1987	$490.28	138	UNICOR	NO MARKET
DLA400-87-F-3343 2/	Sep. 23, 1987	$490.28	183	UNICOR	NO MARKET
DLA400-87-F-2857 2/	Aug. 09, 1987	$490.28	1800	UNICOR	NO MARKET

1/ Quantity is the procurement quantity, actual quantity produced and shipped may vary.
2/ Contract included in audit and determined to be overpriced.
3/ Current market price available for use in negotiating price.

APPENDIX C: PROCUREMENT HISTORY BY NATIONAL STOCK NUMBER
(Continued)

CONTRACT NUMBER	AWARD DATE	UNIT PRICE	QUANTITY 1/	CURRENT UNICOR/ NOT UNICOR	MARKET/ NO MARKET
		NSN: 5995-00-823-2935			
		CABLE ASSEMBLY, RADIO FREQUENCY			
DLA400-91-F-0386	Dec. 13, 1990	$ 5.73	2080	UNICOR	NO MARKET
DLA400-90-F-0419 2/	Nov. 12, 1989	$ 5.62	2800	UNICOR	NO MARKET
DLA400-89-F-1403 2/	Apr. 27, 1989	$ 5.59	4940	UNICOR	NO MARKET
DLA400-89-F-0998 5/	Mar. 05, 1989	$ 5.59	2800	UNICOR	NO MARKET
DLA400-89-F-0574 2/	Jan. 18, 1989	$ 5.60	1908	UNICOR	NO MARKET
DLA400-88-F-1828 2/	June 11, 1988	$ 5.04	6750	UNICOR	CURRENT MARKET 3/
DLA400-88-M-L035	May 10, 1988	$ 4.95	1400	NOT UNICOR	CURRENT MARKET
DLA400-88-F-0222 2/	Nov. 01, 1987	$ 5.11	3000	UNICOR	NO MARKET
DLA400-86-F-2730 2/	June 28, 1986	$ 5.40	2854	UNICOR	NO MARKET
DLA400-85-F-1109 5/	Feb. 18, 1985	$ 4.97	5100	UNICOR	NO MARKET
DLA400-85-F-0553 2/	Dec. 17, 1984	$ 4.97	1470	UNICOR	NO MARKET
DSA400-73-M-DP16	May 08, 1973	$ 7.50	1	NOT UNICOR	CURRENT MARKET
DSA400-73-F-2845	Dec. 14, 1972	$ 2.85	2113	UNICOR	NO MARKET
DSA400-71-M-9433	Sep. 25, 1970	$ 3.10	284	NOT UNICOR	CURRENT MARKET
		NSN: 6150-01-220-5588			
		CABLE ASSEMBLY, POWER, ELECTRICAL			
DLA400-90-F-0024 2/	Oct. 11, 1989	$360.39	90	UNICOR	NO MARKET
DLA400-89-F-2570	Sep. 25, 1989	$360.39	252	UNICOR	NO MARKET
DLA400-89-F-2404 2/	Sep. 01, 1989	$482.12	12	UNICOR	NO MARKET
DLA400-89-F-2105	July 19, 1989	$381.31	75	UNICOR	NO MARKET
DLA400-88-F-1349 2/	Mar. 16, 1988	$494.47	3400	UNICOR	NO MARKET
DLA400-88-F-0594 2/	Dec. 07, 1987	$443.74	4770	UNICOR	NO MARKET
DLA400-88-F-0040 2/	Oct. 01, 1987	$380.61	160	UNICOR	NO MARKET
DLA400-87-F-3342 2/	Sep. 23, 1987	$380.61	143	UNICOR	NO MARKET
DLA400-87-F-3087 6/	Aug. 31, 1987	$380.61	4499	UNICOR	NO MARKET
		NSN: 5995-01-080-7920			
		CABLE ASSEMBLY, SPECIAL PURPOSE, ELECTRICAL			
DLA400-89-F-1774 2/	May 31, 1989	$ 63.99	315	UNICOR	NO MARKET
DLA400-85-F-2428 2/	July 01, 1985	$ 73.02	50	UNICOR	NO MARKET
DLA400-84-M-A162	Jan. 21, 1984	$ 90.00	30	NOT UNICOR	CURRENT MARKET

1/ Quantity is the procurement quantity, actual quantity produced and shipped may vary.
2/ Contract included in audit and determined to be overpriced.
3/ Current market price available for use in negotiating the price.
5/ Contract included in audit and determined to be a loss.
6/ Contract included in audit and did not have additional profit or loss.

APPENDIX C: PROCUREMENT HISTORY BY NATIONAL STOCK NUMBER
(Continued)

CONTRACT NUMBER	AWARD DATE	UNIT PRICE	QUANTITY 1/	CURRENT UNICOR/ NOT UNICOR	MARKET/ NO MARKET
		NSN: 2590-01-144-8899 WIRING HARNESS, BRANCHED			
DAAE07-89-F-0013 5/	Jan. 30, 1989	$335.50	460	UNICOR	NO MARKET
DAAE07-87-F-0025 5/	Jan. 09, 1987	$178.92	857	UNICOR	NO MARKET
DAAE07-86-F-0004 5/	Jan. 17, 1986	$173.71	857	UNICOR	NO MARKET

1/ Quantity is the procurement quantity, actual quantity produced and shipped may vary.
5/ Contract included in the audit and determined to be a loss.

APPENDIX D: UNIT PRICE MARKUP

U.S. ARMY TANK-AUTOMOTIVE COMMAND

CONTRACT NUMBER	(A) CONTRACT UNIT PRICE	UNICOR[1/] FACTORY UNIT COSTS	(B) UNICOR[2/] ACTUAL UNIT COSTS	MARKUP[3/] (PERCENT)
	NSN: 6150-01-119-4117			
DAAE07-89-F-0076[4/]	$ 383.14	$ 245.28	$ 292.31	131
	NSN: 2590-01-119-4117			
DAAE07-87-F-0063[4/]	$ 378.42	$ 285.91	$ 323.44	117
	NSN: 2590-01-083-5724			
DAAE07-89-F-0017[4/]	$1,720.81	$1,448.25	$1,517.81	113
DAAE07-87-F-0107[4/]	$1,817.9774	$1,510.32	$1,611.32	113

1/ UNICOR Factory Unit Costs is the unaudited sum of direct materials, direct labor, and factory overhead.
2/ UNICOR Actual Unit Costs is the audited sum of direct materials, direct labor, factory overhead, general and administrative costs, and negotiated profit.
3/ The markup percentage is the total of the costs, negotiated profit, and additional profit received and is calculated as (A) divided by (B). The first 100 percent of markup is the costs and negotiated profit. Any percentage over 100 is additional profit.
4/ UNICOR estimated overhead items as direct items.

APPENDIX D: UNIT PRICE MARKUP (Continued)

U.S. NAVY SHIPS PARTS CONTROL CENTER

CONTRACT NUMBER	(A) CONTRACT UNIT PRICE	UNICOR[1/] FACTORY UNIT COSTS	(B) UNICOR[2/] ACTUAL UNIT COSTS	MARKUP[3/] (PERCENT)
	NSN: 1450-01-012-6112			
N00104-88-F-0577[4/]	$834.30	$672.79	$752.97	111
N00104-84-F-0627[4/]	$970.85	$664.35	$658.72	147

DEFENSE ELECTRONICS SUPPLY CENTER

	NSN: 1440-00-118-1922			
DLA900-89-F-0533[4/]	$465.64	$303.03	$362.98	128
DLA900-88-F-0935[4/]	$463.85	$226.80	$226.53	205
DLA900-85-F-0803[4/]	$446.26	$174.61	$198.54	225
DLA900-85-F-0616[4/]	$446.26	$227.99	$257.43	173
DLA900-84-F-0899[4/]	$482.10	$249.21	$280.05	172

1/ UNICOR Factory Unit Costs is the unaudited sum of direct materials, direct labor, and factory overhead.
2/ UNICOR Actual Unit Costs is the audited sum of direct materials, direct labor, factory overhead, general and administrative costs, and negotiated profit.
3/ The markup percentage is the total of the costs, negotiated profit, and additional profit received and is calculated as (A) divided by (B). The first 100 percent of markup is the costs and negotiated profit. Any percentage over 100 is additional profit.
4/ UNICOR estimated overhead items as direct items.

APPENDIX D: UNIT PRICE MARKUP (Continued)

DEFENSE GENERAL SUPPLY CENTER

CONTRACT NUMBER	(A) CONTRACT UNIT PRICE	UNICOR[1/] FACTORY UNIT COSTS	(B) UNICOR[2/] ACTUAL UNIT COSTS	MARKUP[3/] (PERCENT)
	NSN: 5995-01-101-8342			
DLA400-90-F-1356[4/]	$35.01	$11.91	$15.54	225
DLA400-89-F-1145[4/]	$34.70	$19.76	$20.60	168
DLA400-87-F-1834[4/]	$46.67	5/	$43.49	107
DLA400-87-F-0969[4/]	$46.67	5/	$33.40	140
DLA400-86-F-1514[4/]	$45.62	$ 8.84	$ 7.36	620
DLA400-86-F-0013[4/]	$46.59	$ 5.80	$ 6.33	736
	NSN: 5995-01-027-3320			
DLA400-89-F-1146[4/]	$51.47	$32.14	$33.35	154
DLA400-88-F-0446	$52.72	$17.82	$22.29	237
DLA400-87-F-2878[4/]	$52.21	$15.10	$17.96	291
DLA400-87-F-1496[4/]	$51.34	$17.12	$21.55	238
DLA400-87-F-0695[4/]	$51.07	$24.13	$30.29	169
	NSN: 5995-00-823-2935			
DLA400-90-F-0419[4/]	$ 5.62	$ 4.36	$ 4.66	121
DLA400-89-F-1403	$ 5.59	$ 3.12	$ 3.65	153
DLA400-89-F-0574	$ 5.60	$ 6.77	$ 4.18	134
DLA400-88-F-1828[6/]	$ 5.40	$ 4.02	$ 3.67	147
DLA400-88-F-0222	$ 5.11	$ 2.76	$ 3.82	134
DLA400-86-F-2730[6/]	$ 5.04	$ 4.12	$ 4.31	117
DLA400-85-F-0553[6/]	$ 4.97	$ 3.04	$ 3.16	157

1/ UNICOR Factory Unit Costs is the unaudited sum of direct materials, direct labor, and factory overhead.
2/ UNICOR Actual Unit Costs is the audited sum of direct materials, direct labor, factory overhead, general and administrative costs, and negotiated profit.
3/ The markup percentage is the total of the costs, negotiated profit, and additional profit received and is calculated as (A) divided by (B). The first 100 percent of markup is the costs and negotiated profit. Any percentage over 100 is additional profit.
4/ UNICOR estimated overhead items as direct items.
5/ UNICOR Form 9 "Production Order and Cost Sheet" not available.
6/ UNICOR estimate included parts that were not needed to manufacture the product.

APPENDIX D: UNIT PRICE MARKUP (Continued)

DEFENSE GENERAL SUPPLY CENTER

CONTRACT NUMBER	(A) CONTRACT UNIT PRICE	UNICOR[1] FACTORY UNIT COSTS	(B) UNICOR[2] ACTUAL UNIT COSTS	MARKUP[3] (PERCENT)
	NSN: 5995-00-889-0911			
DLA400-90-F-0045[4]	$ 56.08	$ 42.20	$51.65	109
DLA400-89-F-1774[4]	$ 55.72	$ 42.97	$47.57	117
	NSN: 5995-01-080-7920			
DLA400-89-F-1774[4]	$ 63.99	$ 47.77	$51.32	125
DLA400-85-F-2428[4]	$ 73.02	$ 62.44	$61.80	118
	NSN: 5995-01-095-9004			
DLA400-89-F-2306[4]	$ 43.79	$ 24.77	$ 28.65	153
DLA400-87-F-3327[4]	$ 66.46	$ 30.41	$ 39.36	169
DLA400-86-F-3515[4]	$ 65.00	$ 51.91	$ 51.03	127
	NSN: 6150-01-220-5587			
DLA400-90-F-0413[4]	$920.03	$613.42	$617.45	149
DLA400-89-F-0472[4]	$612.80	$ 57.19	$520.51	118
DLA400-88-F-1348[4]	$585.49	$393.64	$450.00	130
DLA400-88-F-0595	$496.81	$411.37	$453.68	110
DLA400-88-F-0067	$490.28	$263.24	$467.33	105
DLA400-87-F-3343	$490.28	$554.41	$455.05	108
DLA400-87-F-2857	$490.28	$497.76	$462.10	106
	NSN: 6150-01-220-5588			
DLA400-90-F-0024[4]	$360.39	$222.36	$243.46	148
DLA400-89-F-2404[4]	$482.12	$440.46	$297.97	162
DLA400-88-F-1349[4]	$494.47	$348.01	$379.52	130
DLA400-88-F-0594	$443.74	$378.34	$413.67	107
DLA400-88-F-0040	$380.61	$155.16	$378.97	100
DLA400-87-F-3342	$380.61	$307.49	$379.75	100

1/ UNICOR Factory Unit Costs is the unaudited sum of direct materials, direct labor, and factory overhead.
2/ UNICOR Actual Unit Costs is the audited sum of direct materials, direct labor, factory overhead, general and administrative costs, and negotiated profit.
3/ The markup percentage is the total of the costs, negotiated profit, and additional profit received and is calculated as (A) divided by (B). The first 100 percent of markup is the costs and negotiated profit. Any percentage over 100 is additional profit.
4/ UNICOR estimated overhead items as direct items.

APPENDIX E: COMMON MISCONCEPTIONS ON PROCURING ITEMS FROM UNICOR

1. **Misconception.** Federal Prison Industries is exempt from all normal pricing techniques because Federal departments and agencies are mandated to buy products from UNICOR before issuing competitive proposals to the private sector.

Fact. The fact that Federal departments and agencies must buy products from Federal Prison Industries before going to the private sector should not influence the pricing techniques used to evaluate the price offered and to determine whether or not the price offered is fair and reasonable.

2. **Misconception.** Federal Prison Industries prices are not negotiable.

Fact. Prices established by Federal Prison Industries can and should be negotiated to arrive at a fair and reasonable price.

3. **Misconception.** As long as the Federal Prison Industries price does not exceed a market price, it is fair and reasonable.

Fact. A reasonable price is the sum of reasonable costs to do the work and a reasonable profit. This may or may not equate to a price expected to be paid if the goods or services were not being procured from Federal Prison Industries. Also, for many of the items procured, there is no real marketplace; therefore, there is no market price for comparison.

4. **Misconception.** No cost or price analysis needs to be performed when procuring from Federal Prison Industries.

Fact. A cost or price analysis should be performed when procuring from Federal Prison Industries to ensure that a fair and reasonable price is achieved. Failure to perform a cost or price analysis thoroughly and properly may well result in the payment of excessive prices.

5. **Misconception.** Only firm-fixed price contracts can be awarded to the Federal Prison Industries.

Fact. The Federal Acquisition Regulation does not specify the type of contract to be awarded to Federal Prison Industries.

6. **Misconception.** When preparing a should cost analysis for procurements from Federal Prison Industries you should use the standard industry classification code to get labor (commercial) rates.

Fact. When preparing a should cost analysis, estimated labor rates for the types of labor that will be used and are fair and reasonable should be used. Thus, since prison labor rates range from $.23 to $1.15 per hour, commercial labor rates should not be used.

7. **Misconception.** Clearances cannot be requested from Federal Prison Industries. Federal Prison Industries can issue a clearance when they choose to do so.

Fact. FAR 8.605 "Clearances" provides the mechanism by which clearances can be requested and obtained from Federal Prison Industries.

8. **Misconception.** DCAA does not and cannot get involved with procurements from Federal Prison Industries.

Fact. Federal Prison Industries is a self-supporting, wholly owned Government corporation of the District of Columbia and, as such, DCAA can and should be involved with procurements from them.

APPENDIX F: SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.a. and 1.b.	Compliance with Regulations	Undeterminable
2	Compliance with Regulations Clarification of Profit Policy	Undeterminable
3	Compliance with Regulations Compliance with Regulations	Undeterminable
4	Economy and Efficiency by Requesting a Voluntary Refund of $81,349 to Tank-Automotive Command.	Questioned Costs of $81,349
5	Economy and Efficiency by Requesting a Voluntary Refund of $372,025 to Navy Ships Parts Control Center.	Questioned Costs of $372,025
6	Economy and Efficiency by Requesting a Voluntary Refund of $233,237 to Defense Electronics Supply Center.	Questioned Costs of $233,237
7	Economy and Efficiency by Requesting a Voluntary Refund of $1,143,170 to Defense General Supply Center	Questioned Costs of $1,143,170

We believe that Recommendations 1, 2, and 3 will result in more economical procurements.

APPENDIX G: PRINCIPLE ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Director of Defense Procurement, Washington, DC

Department of the Army

U.S. Army Contracting Support Agency, Great Falls, VA
U.S. Army Tank-Automotive Command, Warren, MI

Department of the Navy

U.S. Naval Supply Systems Command, Arlington, VA
U.S. Navy Ships Parts Control Center, Mechanicsburg, PA

Department of the Air Force

Operational Contracting Division, Office of the Assistant Secretary of the Air Force (Acquisitions), Arlington, VA

Defense Activities

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Electronic Supply Center, Dayton, OH
Defense General Supply Center, Richmond, VA

Department of Justice

Federal Prison Industries, Washington, DC
Federal Prison Industries, Lexington, KY
Federal Prison Industries, Oxford, WI
Federal Prison Industries, Memphis, TN

APPENDIX H: FINAL REPORT DISTRIBUTION

Office of the Secretary of Defense

Under Secretary of Defense for Acquisitions
Director of Defense Procurement
Assistant Secretary of Defense (Production and Logistics)
Assistant Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Assistant Secretary of the Army (Research, Development and Acquisitions)
Commander, U.S. Army Tank-Automotive Command

Department of the Navy

Secretary of the Navy
Comptroller of the Navy
Assistant Secretary of the Navy (Financial Management)
Assistant Secretary of the Navy (Research, Development, and Acquisitions)
Commander, U.S. Navy Ships Parts Control Center

Defense Activities

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Electronics Supply Center
  Commander, Defense General Supply Center

Department of Justice

Department of Justice, Inspector General
Department of Justice, Federal Prison Industries

Non-DoD

Office of Management and Budget
U.S. General Accounting Office, NSIAD Technical Information Center
Congressional Committees:
  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  Senate Committee on Small Business
  Senate Ranking Minority Member, Committee on Armed Services
  House Committee on Appropriations
  House Subcommittee on Defense, Committee on Appropriations
  House Ranking Minority Member, Committee on Appropriations
  House Committee on Armed Services

Non-DoD (continued)

House Committee on Government Operations
House Committee on Small Business
House Subcommittee on Procurement, Tourism, and Rural Development, Committee on Small Business
House Subcommittee on Legislation and National Security, Committee on Government Operations
Representative Benjamin A. Gilman

APPENDIX I: DETAILED AUDIT RESPONSES TO FEDERAL PRISON INDUSTRIES COMMENTS

1. **FPI comment**. The Federal Prison Industries, Inc. (FPI) stated that as a Government agency, it should not be required to provide certified cost or pricing statements, particularly since FPI concurs with the DoDIG that there should be full information parity in contract negotiations, i.e., that sharing of FPI and DoD cost analysis data will occur.

Audit response. As a Government corporation offering products for sale to other agencies, the FPI should comply with the same standards and expectations required by the Government of private sector contractors. Contractors must comply with the FAR. Government agencies that must buy from FPI, private sector businesses that produce the same kinds of goods made by FPI, and the public at large have a right to know that FPI prices are fairly set. FAR 15.804.3, "Exemptions From or Waiver of Submission of Certified Cost or Pricing Data," states that the contracting officer shall require submission of certified cost or pricing data and FAR 15.804-8, "Contract Clauses," requires the inclusion of clause 52.215-22, "Price Reduction for Defective Cost or Pricing Data," in the contract unless the contracting officer determines that prices are based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation.

FPI prices are not based on adequate price competition, and FPI does not have established catalog or market prices of commercial items sold in substantial quantities to the general public. To receive an exemption based on established prices set by law or regulation, FPI must claim the exemption under a Standard Form 1412 "Claim for Exemption of Submission of Certified Cost or Pricing Data." The FAR sets specific criteria for exemptions from or waiver of certified cost or pricing data and must be adhered to by DoD contracting officers.

The principle of informational parity was established to place the contracting officers on an equal footing or an informational parity with contractors. It is self-evident that during negotiations contracting officers should have knowledge of all facts affecting the pricing of the contract to ensure that reasonable prices are negotiated.

FAR 15.803, "General," prohibits the disclosure of any conclusions, recommendations, or portions of administrative contracting office or auditor reports regarding the proposal of

the contractor because it may significantly compromise the negotiating position of the contracting officer.

2. **FPI comment.** FPI commented that its electronic and electrical cable products were not overpriced in real economic terms, because they are at or below the current market price for comparable products and because profits on these products in the aggregate have not exceeded 6.5 percent in the period covered by the audit. FPI further contends that they are not overpriced in the legal sense, because their statutes require only that they be at or below current market price. Moreover, FPI contends that their prices are reasonable in view of the statutory mandates of the Corporation.

Audit response. Of the 54 contracts reviewed, 48 were overpriced in real economic terms by approximately $1.8 million and only 3 had non-FPI purchases within 1 year of award. The remaining 51 contracts had no non-FPI purchases for a period ranging from more than 1 year to 17 years. Thus, no determination of what constitutes a current market price occurred as required under the statutory language in 18 U.S.C. 4124, which states that Federal agencies shall purchase goods and services available from UNICOR [FPI] at not-to-exceed current market prices, was possible.

The requirement that FPI prices not exceed a current market price is not the only factor to be considered by the contracting officer. Under FAR 15.8, "Price Negotiation," the contracting officer must ensure that supplies and services are procured from a responsible source at a fair and reasonable price. If FPI prices exceed the sum of reasonable costs to do the work plus a reasonable profit, then the price established would not be considered fair and reasonable. As stated above, the price established for 48 of the 54 contracts that we audited was not fair and reasonable.

The FPI contention that profits on products can be aggregated is not in keeping with the provisions of the FAR. FAR 15.802, "Policy," requires contracting officers to price each contract separately and independently and not use proposed price reductions under other contracts as an evaluation factor or consider losses or profits realized or anticipated under other contracts. The FPI philosophy of aggregating losses with profits to discuss profits would require DoD to aggregate a contract with a loss against a contract with an 88 percent profit to arrive at a substantially reduced profit rate. The FPI method distorts the unusually high profit rates achieved on many of their contracts. We do not consider, and we believe that the FAR would not consider, a contract with an 88 percent profit rate as a contract with a fair and reasonable price.

The first law providing for FPI was the Act of July 10, 1918, Chapter 144, 10 Stat. 896, which set the price at current market price. The idea of giving the Attorney General wider latitude in fixing prices was rejected based on the premise that the Government ought not to pay excessive prices for a product produced by itself, particularly if the Government were to be the only customer for products produced with convict labor. In addition, Congress wanted to know if these undertakings were making or losing money, and did not want to give the Attorney General "the power to fix any price he pleases [so that] he can make it appear that the [FPI] is making big money, or that it is losing money." In 1930, Public Law 271, 71st Cong., 2d sess. changed the language on price to "not to exceed current market prices."

Although FPI has a mandate to be self-supporting, we believe that one Federal Agency (DoD) should not pay another Federal Agency (FPI) excessive prices on one contract for products or services to cover losses on other FPI contracts. Conversely, it is difficult to understand why the FPI sells products at a loss, when the labor rates for FPI range from $.23 to $1.15 per hour for production labor. A contracting officer in DoD should not knowingly agree to purchase products at a given price from FPI wherein FPI incurs a loss on the contract. Sales of products at a loss by FPI is self-defeating to the statutory mandate of FPI. If FPI must sell a product at a loss to remain below current market price, then FPI should not be in that product line.

3. **FPI comment**. FPI commented that the products that were the subject of this audit were not overpriced because they were priced at or below current market price, and because the aggregated profit for the products in question was reasonable based on their statutory mandates.

According to FPI, eight of the thirteen products covered by the audit had comparable products, i.e., identical or very similar products whose price could be compared to the FPI price. FPI contends that their price was below the market price on these products. FPI further contends that they saved DoD over $1.9 million on these products, compared to what DoD would have spent had the products been procured on the open market.

According to FPI, profits on the remaining five products were also reasonable based on the fact that these profits were less than the profits on the eight products for which comparables existed.

Audit response. The FPI contention that the products that we reviewed as a part of this audit were not overpriced and that the FPI profit was reasonable, is factually inaccurate.

The claimed "savings" to DoD of $1.9 million by FPI were calculated based on inaccurate and outdated information. For example, for one cable assembly the last non-FPI price had to be adjusted for periods of 12 years. A review of the FPI method of adjusting the last non-FPI price found errors in both the analysis and the actual data used. The FPI analysis did not take into account the potential that the non-FPI price may not have been fair and reasonable. The FPI method of adjusting the last non-FPI price was based only on one factor, a 4 percent inflation factor. The FPI method also did not take into consideration potential price reductions resulting from improved manufacturing processes. The FPI analysis distorted the comparison between FPI prices and non-FPI prices. For example, the FPI erroneous analysis improperly projected a non-FPI price [NSN 5995-00-023-2935]. Using corrected data and the FPI method of adjusting the last non-FPI price, DoD actually spent more money by buying the product from FPI than had been charged by a non-FPI source.

4. **FPI comment.** FPI commented that their authorizing legislation, controls all aspects of its operations, including the establishment of prices. FPI is administered by a Board of six Directors, appointed by the President of the United States, and by Corporate Management, including a Chief Executive Officer, and a Chief Operating Officer. Further, the establishment of prices and profit levels is pivotal to the running of the Corporation. The Corporation is operated through the use of its profits, not from the use of appropriated funds. Establishment of prices is the primary mechanism by which the Board and Corporate Management ensure that the statutory mandates of FPI can be met. The only limitation placed on FPI to set prices is that: the price must be at or below the current market price, and profits must be sufficient so that the Corporation is run on an economic basis in achieving its statutory responsibilities.

Audit response. The DoD Contracting officers have the responsibility to award contracts that are fair and reasonably priced, and not to subsidize FPI. Central to the operation of FPI is their cost estimating and cost accumulation systems. If FPI is to operate through the use of its profits and not through appropriated funds, then FPI must maintain accurate cost estimation and cost accumulation data.

Overcharging on certain contracts and undercharging on others is not the mechanism by which to ensure that statutory mandates of FPI are met, even if the overall earnings level for FPI does not appear excessive. FPI should concentrate on establishing prices based on accurate cost estimation and cost accumulation data. We commend FPI for recognizing their weaknesses in cost estimation and accumulation procedures and planning corrective action. The FPI correction of weaknesses, relating to cost estimation and accumulation can eliminate the need for FPI to make defensive arguments in favor of a pricing policy based on flawed cost data.

5. FPI comment. FPI commented that the products that were the subject of this audit were priced at or below market price. In the aggregate, the profit for cable assemblies sold to DoD over the same period covered in the audit did not exceed 6.5 percent and that this was a reasonable return on sales. FPI further maintained that the audit sample was not randomly selected.

Audit response. Prices from FPI were not at or below current market prices, and it is inappropriate to aggregate profits and losses on contracts. The contention of FPI that the audit sample was not randomly selected is inaccurate. The audit sample was randomly selected by the DoDIG statistician. We concluded audit work after completion of a portion of the random sample because of the significant problems uncovered in cost estimating and accumulating by FPI. We deemed it prudent to allow FPI an opportunity to correct the costing deficiencies identified before conducting any additional work.

6. FPI comment. FPI commented that the DoDIG ignored controlling regulations which explicitly provide that comparable pricing can be determined by adjusting for inflation and fluctuation in materials. The FPI cited DLA Acquisition Regulation 4105.1, Section 8.604-90(a)(3), "Pricing Policies For Awards To Federal Prison Industries, Inc.," which states:

> "When a contract action involves allotment to FPI of the entire quantity of the required item and current market quotations are not available, prior contract prices (adjusted to reflect changes in market prices of components since the last contract and differences in any other cost factors, e.g., labor, operation supplies, employee fringe benefits) shall be used as the basis for determining the current market price."

FPI further contends that since the DLA regulation does not limit current prices to those incurred within the same year, that prices can easily be adjusted by taking known variables into account.

Audit response. DLA Regulation 4105.1, Section 8.604-90(a)(3) does not state that current market value is the only factor to be considered. The assertion of FPI that the DLA regulation stands alone is incorrect. The regulation must be read in conjunction with the FAR as a whole. Therefore, the requirement that FPI prices not exceed a current market price is not the only factor to be considered by the contracting officer. The contracting officer under FAR 15.8, "Price Negotiation," must also ensure that supplies and services are procured at a fair and reasonable price. DLA Regulation 4105.1, Section 8.604-90(a)(3) does not excuse the contracting officer from determining a fair and reasonable price. It merely provides one possible method out of many to attempt to determine a current market price. Further, the DLA regulation is only applicable to DLA activities and not to all other DoD activities.

7. **FPI comment.** FPI commented that DoDIG faults contracting officers for following DLA Regulation 4105.1 Section 8604-90 paragraph (a)(4), "Acquisitions from Federal Prison Industries," which concludes that "A quotation from FPI at or less than the determined current market price shall be accepted."

Audit response. Only 3 of the 54 contracts reviewed had non-FPI purchases within 1 year of award. Thus, a sound determination of current market price was not possible on 51 of the contracts. The assertion of FPI that DLA Regulation 4105.1 section 8604-90(a)(4) stands alone is incorrect. DLA Regulation 4104.1 section 8604-90(a)(4) is not the only regulation applicable to FPI and must be read in conjunction with the FAR as a whole. FAR 1.3, "Agency Acquisition Regulations," authorizes an agency head to issue or authorize the issuance of agency acquisition regulations that implement or supplement the FAR and incorporate, together with the FAR, agency policies and procedures that govern the contracting process or otherwise control the relationship between the agencies and contractors. Thus, the provisions covered by FAR 15.802, which requires that contracting officers purchase supplies and services from responsible sources at fair and reasonable prices, also applies. In addition, DLA Regulation 4105.1 section 8604-90(a)(4) is only applicable to DLA activities and not to the other DoD activities.

8. **FPI comment.** FPI commented that they have no reason to believe that profit levels set by DoD contracting officers will accomplish the diverse mandates of FPI. FPI stated that profit levels must be looked at on an aggregated level as well as on an individualized basis to determine whether prices are reasonable.

Audit response. Profit levels are not set by DoD contracting officers. Profit levels on specific contracts are a result of negotiations between DoD contracting officers and FPI. The contention of FPI that profits on products can be aggregated is not in keeping with the FAR. It is the responsibility of FPI to ensure that FPI accomplishes their mandates, not the responsibility of a DoD contracting officer. The responsibility of a DoD contracting officer is to ensure that each and every contract is awarded at a fair and reasonable price and that DoD is not overcharged. A contracting officer in DoD should not knowingly negotiate a contract that provides a loss to FPI. If FPI obtained a reasonable profit on every contract and has prudent management of the profits, then FPI should accomplish its mandates.

9. **FPI comment.** FPI commented that the price negotiation provision of FAR subpart 15.8, "Price Negotiation," was not contemplated for FPI by citing the provision for resolution of disputes covered in 18 U.S.C. section 4124(b). The FPI further stated that FAR 8.605(b), "Clearances," states that price is not ordinarily grounds for refusing to purchase from FPI.

Audit response. FAR 15.8, "Price Negotiation," prescribes the cost and price negotiation policy and procedures applicable to initial and revised pricing of negotiated prime contracts. The DoD contracts awarded to FPI and reviewed during this audit were negotiated prime contracts and as such were covered by the provisions of FAR 15.8. While 18 U.S.C. section 4124 sets up an exclusive process for arbitration of disputes about FPI prices, it does not preclude application of FAR policy and procedures. The FAR must in fact be applied in harmony with provisions for resolution of disputes covered in 18 U.S.C. section 4124(b). In addition, we have not suggested that contracting officers should ordinarily refuse to purchase from FPI, only that contracting officers must and should obtain a fair and reasonable price. Contracting officers should seek to resolve pricing issues with FPI, and only absent such resolution, should they request arbitration. It is unlikely that any contracting officer will currently request resolution of a pricing dispute because the board that handles pricing disputes for FPI sales consists of the President of the United States, the Comptroller General, and the Administrator of the General Services Administration or their representatives.

10. **FPI comment.** FPI commented that estimates cannot realistically be expected to coincide with actual expenses -- at least not until the cost accumulation and estimation system of FPI is refined, and there is complete agreement on what cost elements are acceptable to the DoD. The FPI further stated that public policy should not favor reimbursement of private companies for losses in order to prevent abuses in original estimates, but

suggests that this should not apply to FPI because it is a Government agency. FPI insists that the DoDIG improperly treats FPI as a private sector company.

Audit response. We agree that estimates do not always exactly coincide with actual expenses; however, on 48 contracts; valued at $11.7 million, the difference was about $1.8 million (15.4 percent) in overpricing. On five contracts, valued at $786,133, the difference was $288,047 (36.6 percent) in underpricing. The FPI is now and was then responsible for the accuracy of its cost accumulation and estimating systems. The FPI, as a Government agency, is not excused from adhering to good business practices, including having a good cost accounting system. The FPI operates on a nonappropriated fund basis. The nonappropriated fund activities in DoD and the Federally Funded Research and Development Centers (FFRDC), sponsored by the Government, are similar to FPI in many aspects and those organizations must comply with the FAR in their contracting. FPI was treated no differently than any nonappropriated fund activity or FFRDC audited by the DoDIG.

11. **FPI comment.** FPI commented that the decisions of DoD procurement officials to award contracts to FPI was based on achieving optimal overall pricing rather than on an analysis of the individual cost elements; that the DoDIG analysis was based on an after the fact analysis of individual cost elements, rather than on a comparison of market pricing. FPI cites FAR section 15.901, "General," as stating that "...Negotiations aimed merely at reducing the function of profit, are not in the Government's interest..." FPI further cites Armed Forces Pricing Manual as stating that negotiations in fixed price contracting should avoid negotiating each element of cost because that leads to higher pricing than do negotiations aimed at optimum price. The FPI also stated that the analysis of contracts in terms of cost elements by the DoDIG, comparing estimated costs with reconstructed actual costs, was inconsistent with the original contract negotiations.

Audit response. The assertion of FPI that DoD contracting officers attempted to achieve optimal pricing is correct. DoD contracting officers negotiated in good faith with FPI officials to achieve a fair and reasonable price on contracts. The contention of FPI that an analysis of contracts during an audit is inconsistent with the original contract negotiations is factually inaccurate. If the pricing policy of FPI was consistent with 18 U.S.C. 4124 and cost estimating and cost accumulation procedures and practices were adequate to ensure the development of fair and reasonable prices, an audit of individual cost elements would not have uncovered the overpricing and underpricing. DoD should not have to rely on a later audit

of the records of FPI to establish overpricing and the entitlement to refunds on specific contracts. We believe that overpricing would not have occurred had DoD had current, complete, and accurate cost or pricing data from FPI at the time of negotiations. Later access to FPI records showed that FPI provided erroneous information to contracting officers in DoD, and that FPI had other, more accurate information available prior to negotiations that showed the information provided was erroneous.

12. **FPI comment to Recommendation 1.a.(1)** FPI commented that to be consistent with the principle of informational parity, the DoDIG should also recommend that DoD procurement officials share their relevant cost and pricing data with FPI to ensure that FPI is producing at the lowest possible price.

Audit response. The principle of informational parity was established to place the contracting officers on an equal footing or an informational parity with contractors. It is self-evident that during negotiations, contracting officers should have knowledge of all facts affecting the pricing of the contract to ensure that reasonable prices are negotiated.

A high level of business security must be maintained in order to preserve the integrity of the acquisition process. Contracting officers are prohibited under FAR 5.4, "Release of information," from discussing with potential contractors information obtained from outside the Government and used in preparing Government estimates. In addition, FAR 15.803, "General," prohibits the disclosure of any conclusions, recommendations, or portions of administrative contracting officer or auditor reports regarding the proposal of the contractor because it may significantly compromise the negotiating position of the Government.

The responsibility for ensuring that FPI is producing and selling its goods and services at the lowest price rests solely with FPI. The prenegotiation position of a DoD contracting officer should not be the only means by which FPI ensures that it is recovering the sum of reasonable costs to manufacture the product plus a reasonable profit.

13. **FPI comment to Recommendation 1.a.(2).** The FPI commented that as a wholly owned Government corporation it should not be required to provide certified cost and pricing data.

Audit response. An October 4, 1991, opinion from the Office of General Counsel, DoD, states that FPI can be required to provide cost or pricing data when requested by a contracting officer. In addition, FAR 15.804-3, "Exemptions From or Waiver of Submission of Certified Cost or Pricing Data," states that the

contracting officer shall require submission of certified cost or pricing data, and FAR 15.804-8, "Contract Clauses," requires the inclusion of clause 52.215-22, "Price Reduction for Defective Cost or Pricing Data," in the contract unless the contracting officer determines that prices are based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation.

The FPI prices for the contracts reviewed were not based on adequate price competition, and FPI does not have established catalog or market prices of commercial items sold in substantial quantities to the general public. To receive an exemption based on established prices set by law or regulation, FPI must claim the exemption under a Standard Form 1412 "Claim for Exemption of Submission of Certified Cost or Pricing Data." The FAR sets specific criteria for exemptions from or waiver of certified cost or pricing data and must be adhered to by DoD contracting officers.

Under FAR 15.804-3(h), even when an exception to the submission of certified cost and pricing data has been granted, contracting officers must make a price analysis to determine the reasonableness of the price and any need for further negotiation.

14. **FPI comment on Recommendation 1.a.(3).** FPI commented that guidance to contracting officers on conducting purchases from FPI should not include requirements for contracting officers to request field pricing support in accordance with FAR 15.805-5, "Field Pricing Support." FPI contends that an audit by DCAA may be beyond the scope of intergovernmental operations in that these audits may be in the GAO or IG areas of expertise since they cross Executive Branch agencies.

Audit response. FAR 15.805-5, "Field Pricing Support," states that when cost or pricing data are required, contracting officers shall request a field pricing report before negotiating any contract or modification resulting from a proposal in excess of $500,000, except in limited circumstances. The DCAA was established for the express purpose of performing contract auditing for DoD and as such has the most capacity and expertise to furnish timely, fully adequate field pricing support to DoD contracting personnel. We recognize, of course, that other Government audit organizations are also qualified to perform contract audit functions. Determining whether the DCAA has legal authority to perform audits at FPI, as we recommend in this report, would be a logical first step in determining how best to meet the requirement for audit support.

15. **FPI comment on Recommendation 1.b.**. FPI commented that they conduct training with General Services Administration procurement officials outlining the differences in procurement from FPI versus the private sector and offers the assistance of FPI with DoD training.

Audit response. The Director of Defense Procurement should determine the extent of participation of FPI in a DoD training program related to FPI.

16. **FPI comment on Recommendation 2.** FPI concurred that it has started to coordinate with the Director of Defense Procurement on the reasonableness of profits for individual contracts.

17. **FPI comment on Recommendation 3.** FPI commented that DCAA should consult with the DoDIG, the Department of Justice IG, and perhaps the GAO before initiating additional audits of FPI.

Audit response. We agree that consultation and coordination between the agencies named above would be essential.

18. **FPI comment on Recommendations 4, 5, 6, and 7.** FPI commented that it does not dispute findings of cost estimating inaccuracies. FPI suggests that the audit report did not show instances of FPI prices exceeding current market price, or defective pricing. The FPI did not agree that overpricing has occurred.

Audit response. The audit did not attempt to perform a market survey to determine if the prices from FPI exceeded current market prices. Also, because the FPI did not certify the accuracy, completeness, and currency of its pricing data, defective pricing did not occur, in the technical sense. Therefore, the only recourse for DoD in the instances of overpricing disclosed by our audit is to request a voluntary refund.

19. **FPI comments on corrective actions in process to the Management Letter issued to FPI by the Office of Inspector General, DoD.** FPI commented that it was examining its cost estimating system along with methods of allocating general and administrative costs. In addition, problems at one FPI factory will be examined and used as the basis for determining the effectiveness of current cost management policies and the development of future management training. FPI is also undertaking a review of the Armed Services Pricing Manual to ensure that FPI policy and the guidelines of this manual are consistent. In addition, FPI is in the process of changing its information system to make the information more relevant.

20. **FPI comment on Appendix A.** FPI commented that "three columns entitled "Additional Profit" are displayed and are explained below the table as being that profit above the profit rate agreed to at the time of negotiations, as if profit was the prime point of negotiations. Particularly for fixed-price contracting, price, not profit, is the prime negotiating point."

Audit response. DoD contracting officers have a duty to procure supplies and services from a responsible source at a fair and reasonable price. If the FPI prices exceed the sum of reasonable costs to do the work plus a reasonable profit, then the price established would not be considered fair and reasonable.

21. **FPI comment on Appendix C.** FPI commented that the tables do not support the finding. If a current market price is shown in the "Market/No Market" column, it appears the FPI price was under the market price in nearly all cases.

Audit response. As the chart clearly shows, only 3 of the 54 contracts reviewed had non-FPI purchases within 1 year of award. The remaining 51 contracts had no non-FPI purchases for a period ranging from more than 1 year to 17 years; thus, no market price could be determined. Of the three contracts having a market price, DoD actually lost approximately $14,000 by procuring the item from the FPI.

22. **FPI comment on Appendix D.** FPI commented that the "Markup" (Percent) column exaggerates the estimated markup. Appendix D would have a price of $120 on a cost of $100 as a 120-percent markup, when in actuality it is a 20-percent markup. In fact, a 120-percent markup on a cost of $100 would generally mean a price of $220. Markup is traditionally defined as "an amount added to the cost price to determine the selling price." The DoDIG report has markup defined in contradictory terms, first as the difference between the cost and selling price, then as the selling price divided by the cost price. It clearly is the difference divided by the cost; not the selling price divided by the cost, because that adds 100 percent to the difference.

Audit response. The footnote in Appendix D has been clarified to clearly explain markup.

PART IV - MANAGEMENT COMMENTS

Assistant Secretary of the Army (Research, Development, and Acquisitions)

Federal Prison Industries, Inc.

MANAGEMENT COMMENTS FROM THE DEPARTMENT OF THE ARMY

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S ARMY CONTRACTING SUPPORT AGENCY
WASHINGTON, DC 20310-0103

REPLY TO
ATTENTION OF

SFRD-KP

24 SEP 1991

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE ATTN: AUDITING, 400 ARMY NAVY DRIVE, ARLINGTON VIRGINIA 22202-2884

SUBJECT: Draft Audit Report on DOD Procurements from Federal Prison Industries (Project No. OCH-8010)

Reference is made to your August 5, 1991, memorandum on the subject report which requests comments on the draft findings and recommendations.

We concur with the one "RECOMMENDATION FOR CORRECTIVE ACTION" addressed to the Army. In the enclosed memorandum, the Commander, Tank-Automotive Command agrees to request a voluntary refund of $81,349 from Federal Prison Industries. In addition, the contracting activity will use the Defense Contract Audit Agency resources, that become available as a result of recommendation 3, to review other contracts with Federal Prison Industries for potential overpricing.

J. Bruce King
J. Bruce King
Acting Director

Enclosure

Cf:
SAIG-PA
SARD-DER

DEPARTMENT OF THE ARMY
HEADQUARTERS, U. S. ARMY MATERIEL COMMAND
5001 EISENHOWER AVENUE, ALEXANDRIA, VA 22333-0001

AMCIR-A (36-2b) 20 Sep 91

MEMORANDUM FOR HQDA(SAIG-PA) WASH DC 20310-1700

SUBJECT: DODIG Draft Report, DOD Procurement from Federal Prison Industries, Project OCH-8010 (AMC No. D9051)

1. Reference, memorandum, SAIG-PA, 6 Aug 91, SAB.

2. We are providing the position on subject report IAW AR 36-2. We concur with the actions taken or proposed by TACOM.

3. Point of contact for this action is Mr. Robert Kurzer, 703/274-9023.

FOR THE COMMANDER:

Leonard H. Maguire

LEONARD H. MAGUIRE
Chief, Internal Review and
Audit Compliance Office

Encl
as

DEPARTMENT OF THE ARMY

UNITED STATES ARMY TANK-AUTOMOTIVE COMMAND
WARREN, MICHIGAN 48397-5000

REPLY TO
ATTENTION OF

AMSTA-CJA (36-2b)

19 Sep 91

MEMORANDUM FOR Commander, U.S. Army Materiel Command, ATTN: AMCIR-A
5001 Eisenhower Avenue, Alexandria, VA 22333-0001

SUBJECT: DODIG Draft Report, DODOD Procurement From Federal Prison Industries, Project OCH-8010 (AMC No. D90TE1)

1. Reference memorandum, AMC, AMCIR-A, dated 12 August 1991, SAB.

2. This memorandum is to advise you of our concurrence with the finding and Recommendation 4 directed to TACOM. Our reply details the corrective action taken (Enclosure).

3. Mr. Ronald J. Griessmayer, DSN 786-5658, is the TACOM point of contact for this report.

Encl

LEO J. PIQATT
Major General, USA
Commanding

COMMAND REPLY
DOD Inspector General Draft Report
Audit of DOD Procurements From Federal Prison Indurstries
U.S. Army Tank-Automotive Command

FINDING:

Prices for 13 National Stock Numbers (electronic and electrical cables) that were purchased from UNICOR exceeded costs and negotiated profit, and UNICOR did not submit accurate, complete, and current cost or pricing data to Government negotiators. This occurred because the UNICOR pricing policy was inconsistent with Title 18 section 4124; the UNICOR estimating procedures and practices were not adequate to ensure the development of fair and reasonable prices; and the UNICOR pricing policy and job costing procedures and practices were not followed. In addition, contracting officers did not require UNICOR to submit cost or pricing data as required by FAR subpart 15.8, "Price Negotiation," and did not adequately protect DOD's interests when determining whether prices quoted by UNICOR were fair and reasonable. As a result, 48 (89 percent) of the 54 contracts reviewed were overpriced by approximately $1.8 million.

RECOMMENDATION 4:

We recommend that the Commander, Tank-Automotive Command, request a voluntary refund of $81,349 for contracts listed in Appendix A, page 29, and review other contracts with UNICOR for potential overpricing.

ACTION TAKEN:

Concur. A letter dated 26 August 1991 was sent to UNICOR requesting a voluntary refund totaling $81,348.66 for the four contracts listed in Appendix A. Concerning the other contracts, we will monitor the action taken relative to Recommendation 3. If it is determined that the Defense Contract Audit Agency has authority to audit UNICOR contracts, we will request such audits on an "as needed" basis.

MANAGEMENT COMMENTS FROM FEDERAL PRISON INDUSTRIES, INC.

U.S. Department of Justice

Federal Bureau of Prisons

Office of the Director

Washington, DC 20534

October 4, 1991

Robert J. Lieberman
Assistant Inspector General for Auditing
Department of Defense
Room 808
400 Army Navy Drive
Arlington, Virginia 22202-2884

SUBJECT: Comments to Draft DoD IG Audit Report on DoD Procurements from Federal Prison Industries (Project No. OCH-8010)

Dear Mr. Lieberman:

Enclosed herewith are Federal Prison Industries', Incorporated (FPI/UNICOR) comments on the draft DoD IG report on DoD procurements of electronic assemblies from FPI. FPI understands the draft report and its recommendations are not formally addressed to FPI. Nonetheless, we very much appreciate this opportunity to provide you with our comments because the report will affect in a direct and substantial way the operations of this agency and its future relations not just with DoD, but with all its Federal Government customers. For this reason, we ask that our response in its entirety be an attachment to or made a part of the final report.

In addition, for reasons spelled out in detail in our response, FPI makes the following requests: first, that the report acknowledge that profit levels for electronic cable assemblies were reasonable in the sense that these products were priced at or below current market price resulting in a saving to DoD of over $1.9 million compared to what the products would have cost if they had been purchased on the open market; second, that profits on cable assemblies in the aggregate over the audit period did not exceed 6.5 percent; third, that problems relating to cost estimation and accumulation are currently being addressed pursuant to procedures developed jointly by FPI and the DoD IG; and fourth, that recommendations concerning requests for voluntary refunds be postponed pending submission of questions relating to FPI pricing policy for independent legal review, which we anticipate will be by the Office of Legal Counsel in the U.S. Department of Justice.

Sincerely,

J. Michael Quinlan
Chief Executive Officer,
Federal Prison Industries, Inc.
Director, Federal Bureau of Prisons

RESPONSE BY

FEDERAL PRISON INDUSTRIES, INC.

TO DRAFT REPORT

ON DOD PROCUREMENTS FROM

FEDERAL PRISON INDUSTRIES

(PROJECT NO. OCH-8010)

DATED AUGUST 5, 1991

OCTOBER 4, 1991

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INTRODUCTION

Federal Prison Industries, Inc. (trade name, UNICOR), hereafter referred to as FPI, has completed its review of the "Draft Report on DoD Procurements from Federal Prison Industries," prepared by the Office of the Inspector General, Department of Defense, hereafter referred to as DoD IG, dated August 5, 1991.

The principal findings contained in the Draft Report are: that FPI has significant problems with its cost estimation and accumulation system; and that 48 of 54 electronic cable assembly contracts reviewed during the audit were overpriced by a total of $1.8 million.

FPI generally concurs with the problems identified by the DoD IG concerning cost estimation and accumulation, and steps are now being taken with the assistance of the DoD that will remedy these problems. However, FPI completely disagrees with the findings related to overpricing. In real economic terms, FPI has saved DoD more than $1.9 million on these products, compared to what they would have cost if DoD had purchased them on the open market.

While cost estimation and accumulation procedures are relevant to the determination of price, for reasons explained in this response, costing does not necessarily determine price. Therefore, we analyze and discuss the two items separately in this response.

I. DOD IG FINDINGS AND FPI RESPONSE

DOD IG FINDING CONCERNING FPI COST ESTIMATION AND ACCUMULATION:

The DoD IG stated that FPI did not submit accurate, complete, and current cost or pricing data to Government negotiators, because FPI job costing policies and procedures were not followed. Moreover, the DoD IG cited instances where FPI has failed to share cost or pricing data. Further, while the DoD IG found no instances of defective pricing in the subject procurements, the DoD IG draft report recommends that FPI be required to provide certified cost and pricing statements similar to those required of private sector contractors.

FPI RESPONSE:

FPI acknowledges the errors made in cost estimation and accumulation and is working jointly with DoD in the development of procedures for costing so as to ensure accuracy and consistency. Moreover, FPI has agreed to a full sharing of cost and pricing data with DoD. In a letter dated April 24, 1991 from the Plans and Policy Division of FPI to the Project Manager, DOD IG (Attachment 1), FPI agreed that estimated unit cost statements will be made available to the DoD, or to any other customer agency, when there is a question raised concerning prices. FPI will provide all cost and pricing data to DOD whenever any such items are in dispute.

However, FPI believes that as a Government agency, it should not be required to provide certified cost and pricing statements, especially in view of the fact that FPI concurs with the DoD IG that there should be full information parity in contract negotiations, i.e., that sharing of FPI and DoD cost analysis data will occur.

DOD FINDING CONCERNING FPI PRICING:

The DoD IG stated that prices for 13 National Stock Numbers (electronic and electrical cables) that were purchased from FPI exceeded costs and negotiated profit, because FPI pricing policy was inconsistent with Title 18 U.S.C., Section 4124. As a result, the DoD IG stated that 48 (89 percent) of the 54 contracts reviewed were overpriced by approximately $1.8 million.

FPI RESPONSE:

FPI's electronic and electrical cable products (cable assemblies) were not overpriced in real economic terms, because they are at or below the current market price for comparable products and because earnings on these products in the aggregate have not exceeded 6.5 percent in the period covered by this audit. They are not overpriced in the legal sense, because FPI's statutes only require that they be at or below current market price. Moreover, FPI's prices are reasonable in the light of the Corporation's statutory mandates.

A. FPI's prices are at or below the current market price for comparable items.

The products that are the subject of this audit are not overpriced because they are priced at or below current market price, and because the aggregated profit for the products in question was reasonable in light of FPI's statutory mandates.

The audit covered thirteen products (or National Stock Numbers). For eight of these, there exist comparable products -- that is, identical or very similar products whose price can be compared to FPI's price. FPI was below the market price on these products. In fact, FPI saved DoD over $1.9 million on these products, compared to what DoD would have spent had the products been procured on the open market. (Attachment 2)

Of the remaining 5 products for which there were no comparables, FPI's prices were also reasonable. This is determined by the fact that profits on these products were less than profits on the eight products for which comparables exist.

B. FPI's prices are determined in accordance with FPI's authorizing legislation.

FPI's authorizing legislation (its "charter"), controls all aspects of the Corporation's operations, including the establishment of prices. FPI is administered by a Board of six Directors, appointed by the President, and by Corporate Management, including a Chief Executive Officer (who is also the Director of the Federal Bureau of Prisons) and a Chief Operating Officer (18 U.S.C. 4121, 4122).

The establishment of prices and profit levels (i.e., earnings) is central to the running of the Corporation. The Corporation is operated through the use of its earnings, not from the use of appropriated funds. Establishment of prices is the principal mechanism by which the Board and Corporate Management assure that the Corporation's statutory mandates can be met. The only limitation placed on FPI's discretion to set prices is that: 1) the price

must be at or below the current market price; and 2) profits (i.e., earnings) are to be sufficient so that the Corporation is run on an economic basis in achieving its statutory responsibilities (18 U.S.C. 4124, 4126).

C. FPI's prices for cable assemblies in the aggregate are reasonable.

The products that were the subject of this audit are priced at or below market price, and in the aggregate the profit for cable assemblies sold to the DoD over the same period covered in the audit did not exceed 6.5 percent. This is a reasonable return on sales. Earnings are used for the following purposes: 1) providing employment for the "greatest number of those inmates in United States penal and correctional institutions who are eligible to work as is reasonable possible"; 2) diversifying, so that no single private industry is forced to bear an undue burden of competition; 3) functioning on an economic basis, since the Corporation receives no appropriated funds; and finally, 4) providing for the future needs of the Federal Bureau of Prisons by expanding operations so as to employ the thousands of additional inmates who will be coming into the system. The Bureau's inmate population is expected to increase by half in just the next few years.

The audit sample which the DoD IG maintains was randomly selected, reflects net earnings of 24 percent. This far exceeds the 6.5 percent earned on cable assemblies as a whole. The discrepancy indicates to FPI that the sample was not randomly selected.

D. The DoD IG's definition of current market price is too narrow and contrary to DoD's regulations.

The DoD IG considers FPI's analysis, which looks to comparable pricing and aggregate profits, as irrelevant to the audit findings. It acknowledges the existence of comparables for only three of the 13 products and denies that comparables exist for the remaining products. The DoD IG's reasoning is based on the dictionary definition of "current" (Report Draft, p.10), which is "belonging to the present time or now in progress." Based on this usage, the DoD IG found a current market price existed for only three of the 13 products purchased. In further elaboration of the dictionary definition, the DoD has indicated orally to FPI at a recent briefing that they will not consider any price for a comparable item purchased more than one year prior to the procurement as a current market price.

The dictionary definition of "current" is not useful in determining whether there exist current market prices for comparables. In fact, the DoD IG ignores controlling regulations, which explicitly provide that comparable pricing can readily be determined by adjusting for inflation and fluctuation in materials. DoD's Defense Logistics Agency's (DLA) Acquisition Regulation 4105.1, Section 8.604-90(a)(3) states, "When a contract action involves allotment to FPI of the entire quantity of the required item and current market quotations are not available, prior contract prices (adjusted to reflect changes in market prices of components since the last contract and differences in any other cost factors, e.g., labor, operating supplies, employee fringe benefits) shall be used as the basis for determining the current market price." The DLA regulation does not limit current prices to those incurred within

the same year; in fact, it suggests that prices can easily be adjusted by taking known variables into account.

E. DLA Regulations provide FPI quotation should be accepted.

The DoD IG faults the contracting officer (Draft Report, p.10) for "interpreting the language in Title 18, Section 4124 to mean that, if the FPI price is within a current market price range, the price should be accepted regardless of actual cost incurred by FPI to produce the item." However, DLA regulations (4105.1 Section 8604-90) at paragraph (a)(4) conclude "A quotation from FPI at or less than the determined current market price shall be accepted." (Emphasis added.) This is precisely what the DoD IG has faulted the contracting officer for doing.

F. Until costing procedures have been revised, an aggregate approach to pricing is needed.

The draft report also states that in accordance with the Federal Acquisition Regulation (FAR), the contracting officers must price each contract separately and independently and not consider a contractor's losses or profits realized or anticipated under other contracts. There is no reason to believe that profit levels set by contracting officers in individual contracts will accomplish the diverse mandates of FPI, as set out above. Because the Corporation must diversify and employ as many inmates as reasonably possible, it must produce a wide range of products. Some will be economically viable; others may be less viable, or may even lose money in the short run or due to unforeseen circumstances. Therefore, profit levels must be looked at on an aggregated level as well as on an individualized basis to determine whether prices are reasonable.

G. FPI'S statute contains its own provision for resolution of disputes in prices.

As further indication that the price negotiation provisions of FAR subpart 15.8, "Price Negotiation," were written with private sector suppliers in mind, and that these provisions never contemplated the very different case of FPI, there is a completely separate process for disputing prices that applies to FPI and has been in existence since 1934. This process is established at 18 U.S.C. 4124 (b). While it has not been used, this does not mean that the provision in the FAR is appropriate to displace it. In fact, the FAR handles pricing issues for FPI differently than it does for private sector contractors, by explicitly stating, at 8.605 (b), that price is not ordinarily grounds for refusing to purchase from FPI.

H. Refusal to consider FPI's unanticipated losses for reimbursement improperly treats FPI as a private company.

Estimates cannot realistically be expected to exactly coincide with actual expenses -- at least not until the cost accumulation and estimation system is refined and there is complete agreement on what cost elements are acceptable to the DoD. While public policy should perhaps disfavor reimbursement of private companies for losses in order to prevent abuses in original estimates, this does not apply to FPI as a Government agency. Failure

to consider unanticipated losses is still another way that the DoD IG improperly treats FPI as a private sector company.

I. Fixed-price contracts are based on overall pricing considerations and not on individual cost elements.

The contracts at issue are fixed-price contracts and so the emphasis is on price compared to market price rather than individual cost items. The decisions of DoD procurement officials to award contracts to FPI was based on achieving optimal overall pricing rather than on an analysis of the individual cost elements; yet the DoD IG analysis is clearly based on an after the fact analysis of individual cost elements rather than on a comparison of market pricing.

The FAR guidance on fixed price contracting is that price, not profit, is the crux of contract negotiation and furthermore, that profits should be encouraged as a means of encouraging marketplace economic efficiencies for the Government. The FAR, in Section 15.901, states that "both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing the function of profit, are not in the Government's interest..." Additionally, the Armed Forces Pricing Manual clearly suggests that negotiations in fixed price contracting should avoid negotiating each element of cost because that leads to higher pricing than do negotiations aimed at optimum price.

DoD-FPI fixed price contracts were negotiated on the basis of achieving overall price savings to DoD, not on the basis of analyzing individual elements of contract cost. The Armed Forces Pricing Manual recommends the former approach, because negotiating cost elements leads to higher prices.

After the fact, the DoD IG analyzed the contracts in terms of cost elements, comparing estimated costs with eventual reconstructed actual costs -- an approach inconsistent with the original contract negotiations. These basic principles apply in DoD-FPI fixed price contracts. Nonetheless it is important to reiterate that FPI will negotiate at any time there is a dispute that arguably would affect price.

II. DOD IG RECOMMENDATIONS AND FPI RESPONSE

DOD IG RECOMMENDATION 1. *We recommend that the Director of Defense Procurement, Assistant Secretaries of the Army (Research, Development, and Acquisition) and the Navy (Research, Development, and Acquisition); and the Director, Defense Logistics Agency:*

a. Provide guidance to contracting officers on conducting purchases from FPI. The guidance should include requirements for contracting officers to:

> *(i) Request and obtain from FPI accurate, complete, and current cost or pricing data sufficient to determine fair and reasonable prices and to negotiate procurements directed to FPI.*
>
> *(ii) Request and obtain from FPI certified cost and pricing data in accordance with Federal Acquisition Regulation 15.804 "Cost or pricing data," and to include the appropriate defective pricing clauses or formally request waivers from the requirement.*
>
> *(iii) Request field pricing support in accordance with Federal Acquisition Regulation 15.805.5 "Field pricing support."*

b. Include appropriate instruction on conducting procurements from FPI in the acquisition training curriculum.

FPI RESPONSE 1.a.i.: FPI concurs. As previously agreed, FPI will submit cost and pricing data. At a recent briefing, the DoD IG informed FPI that requests by FPI for "should cost" analyses needed to be made through the Freedom of Information Act. This is not in the spirit of information parity and full disclosure. FPI requests that DoD procurement agencies be instructed to share their cost\price analysis data with FPI. While the DoD IG Draft indicates information parity did not exist between FPI and DoD customers, the draft only recommends that DoD obtain data from FPI. To be consistent with the principle of full information parity, the DoD IG should also recommend that DoD procurement officials share their relevant cost and price data with FPI to assure that FPI is producing at the lowest possible price.

FPI RESPONSE 1.a.ii.: FPI does not concur. As previously indicated, the FAR guidance for such certifications, carrying the possibility of negative sanctions including interest payments and penalties, is clearly aimed at private sector contractors. FPI as a wholly owned Government corporation should not be required to provide such certifications, especially in view of the fact that FPI agrees with the DoD IG that there should be full information parity in contract negotiations, i.e. sharing of FPI and DoD cost analysis data should occur.

FPI RESPONSE 1.a.iii.: FPI does not concur. The pricing support as recommended implies that additional audits could be forthcoming each time a contract exceeds $500,000. Again, FPI is treated as a private sector entity in this regard. FPI maintains that the Director, Defense Contract Audit Agency (DCAA) should consult with the DoD IG, the Department of Justice IG, and perhaps the General Accounting Office before initiating additional audits of FPI.

Following General Accounting Office direction, FPI is audited annually by independent accounting firms and throughout the year by internal control components of the Federal Bureau of Prisons to ensure that applicable regulations are followed. Additionally, Department of Justice and Inspector General offices audit FPI. Now the DoD IG has also audited FPI's operations. The addition of another DoD audit agency such as the DCAA, may be beyond the scope of intergovernmental operations in that these audits may be in the GAO or IG areas of expertise since they cross Executive Branch agencies.

FPI RESPONSE 1.b.: FPI concurs. FPI offers its input into this process. As another Government agency, FPI conducts training with General Services Administration procurement officials outlining the differences in procurement from FPI versus the private sector. It would be beneficial to all to ensure that misconceptions and myths are clarified in such training.

DOD-IG RECOMMENDATION 2. *We recommend that the Director of Defense Procurement coordinate with the Federal Prison Industries on the parameters of reasonableness for FPI profits on individual contracts.*

FPI RESPONSE: FPI concurs. As mentioned above, FPI and DoD have discussed a process to resolve this issue.

DOD-IG RECOMMENDATION 3. *We recommend that the Director, Defense Contract Audit Agency, obtain a legal opinion on whether they can provide contract audit support for FPI proposals and contracts.*

FPI RESPONSE: FPI does not concur. As noted in the response to Recommendation 1.a.iii., FPI maintains that the Director, Defense Contract Audit Agency (DCAA) should consult with the DoD IG, the Department of Justice IG, and perhaps the General Accounting Office before initiating additional audits of FPI.

The following DoD IG Recommendations will be addressed together.

DOD-IG RECOMMENDATION 4. *We recommend that the Commander, Tank-Automotive Command, request a voluntary refund of $81,349 for contracts listed in Appendix A, page 29, and review other contracts with FPI for potential overpricing.*

DOD-IG RECOMMENDATION 5. *We recommend that the Commander, Navy Ships Parts Control Center, request a voluntary refund of $372,025 for contracts listed in Appendix A, page 30, and review other contracts with FPI for potential overpricing.*

DOD-IG RECOMMENDATION 6. *We recommend that the Commander, Defense Electronics Supply Center, request a voluntary refund of $233,237 for contracts listed in Appendix A, page 30, and review other contracts with FPI for potential overpricing.*

DOD-IG RECOMMENDATION 7. *We recommend that the Commander, Defense General Supply Center, request a voluntary refund of $1,143,170 for contracts listed in Appendix A, page 31 to 33, and review other contracts with FPI for potential overpricing.*

FPI RESPONSE: FPI does not concur. As indicated above, FPI does not dispute findings of cost estimating inaccuracies and has taken or is taking corrective action to resolve these problems. However, the DoD IG Draft Report did not show any instances of: 1) FPI prices exceeding current market price, or 2) defective pricing. For reasons explained in FPI's response to the DoD IG's finding concerning pricing (Section I.), FPI does not agree that overpricing has occurred.

III. FPI CORRECTIVE ACTIONS

FPI has not taken issue with the fact that its cost estimating procedures must be improved. This is an issue which was addressed in a Management Letter furnished to the FPI Board of Directors. Because the Letter is incorporated by reference in the Draft Report (Draft, p. 15), FPI is reporting corrective actions taken to date as a result of the cost estimating discrepancies. These actions are described below by subject.

1. Unit Cost Estimates. Preliminary work has begun on unit cost estimates. The processes by which each division prepares this estimate will be examined and general and administrative costs will be addressed. The method to allocate general and administrative costs will be developed and an anticipated October 7, 1991 date is set for completion.

2. Case Study. Problem areas at one FPI factory will be examined and used as the basis for development of future management training. The effectiveness of current cost management policies will be included in the factory examination. An anticipated completion date is not yet available pending the results of the site visit.

3. Pricing Policy. A review of the Armed Services Pricing Manual will be undertaken to assure that FPI policy and the guidelines of this manual are consistent. It is anticipated that this review will be accomplished by October 2. Additionally, FPI and DOD will work on resolution of the issue of reasonable price.

4. Accounting Controls/Cost Accounting System/Production Management System. Since FPI is in the process of changing its information system to make the information more relevant, there are short and long term actions which are being undertaken.

In the short term (pending full implementation of the new system) the following actions have or will be taken:

a. Development of detailed summaries of deficiencies from all recent Bureau of Prisons program reviews requiring each division/location to ensure compliance with all current requirements.

b. Development of suggestions for completing job analysis and how this can be accomplished on a daily basis. This includes non-financial measurements.

c. Provision of examples to factories of the indicators which determine usefulness/effectiveness of the cost system. The local factories could request assistance in making changes or getting waivers to the current system.

d. Reduction of current requirements for form completions and similar items where the requirement is impractical or not useful.

In the long term, the cost management system will include:

a. Formalized short term actions.

b. Full utilization of system capabilities to enhance and make data accumulation and analysis timely, accurate, and efficient.

c. Review the possible development of general cost management policy with product division supplements which address each of their specific operating circumstances.

d. Analysis of alternative methods of accounting for and allocating direct labor and overhead.

e. Definition of various options and results of each allocation that must be considered to determine individual factory and division capabilities relative to overhead and production cost estimation.

f. Formalized use of work measurement standards in all related cost management functions.

g. Simplified cost accounting requirements.

IV. FPI COMMENTS ON DOD IG's APPENDICES TO DRAFT REPORT

Presentation of Data. FPI has serious reservations with the presentation of statistical data in the appendices of the report. The presentations are conflicting and misleading.

Appendix A. Three columns entitled "Additional Profit..." are displayed and are explained below the table as being that profit above the profit rate agreed to at the time of negotiations, as if profit was the prime point of negotiation. Particularly for fixed price contracting, price, not profit, is the prime negotiating point.

Appendix C. The tables do not support the finding, i.e. if a current market price is shown in the "Market/No Market" column, it appears the FPI price was under the market price in nearly all cases.

Appendix D. The "Markup" (Percent) column exaggerates the estimated markups, e.g., Appendix D would have a price of $120 on a cost of $100 as a 120 percent markup, when in actuality it is a 20 percent markup. In fact, a 120 percent markup on a cost of $100 would generally mean a price of $220. Markup is traditionally defined as "an amount added to the cost price to determine the selling price." The DoD-IG report has markup defined in contradictory terms, first as the difference between the cost and selling price, then as the selling price divided by the cost price. It clearly is the difference divided by the cost; not the selling price divided by the cost, because that adds 100 percent to the difference.

V. FPI RESPONSE CONCLUSION

The DoD IG Draft Report concludes that the audit has revealed "overpricing." But there has been overpricing only in the narrow sense that FPI's profits were higher than the profits that were originally identified between FPI and DoD when an overall price was originally negotiated. In real economic terms, FPI saved the DoD $1.9 million on the same contracts which the audit asserts were overpriced. In sum, the DoD IG has confused cost accumulation issues with pricing issues. Cost estimation and accumulation is relevant to, but does not determine, price. The DOD IG has properly identified problems related to cost accumulation and estimation, and the proper solution to these problems have to do with cost accumulation and estimation, not with pricing. With the assistance of DoD, we are now in the process of putting an appropriate cost estimation and cost accumulation system into place. No further remedial action is called for.

ATTACHEMENT 1

U.S. Department of Justice
UNICOR
Federal Prison Industries, Inc

Washington, DC 20534

April 24, 1991

Victoria Hara
Project Manager/DOD-IG
400 Army-Navy Drive, Suite 600
Arlington, VA 22202

Dear Ms. Hara:

This is to formalize our response to the question we have discussed regarding the availability of our unit cost statements. You indicated to me there was concern that FPI had not been making available to the Department of Defense (DOD) estimated unit cost statements as a means of verifying the reasonableness of FPI's prices.

We agree that these itemized statements should be made available to the Department of Defense, or for that matter to any other customer agencies, when there is a question concerning prices. In fact they are routinely turned over in such circumstances. The current agreement we have worked out with several DOD buying agencies of turning the cost statements over when there is a genuine question or dispute, rather than routinely, seems to be a good one and should be continued.

While costs are a very important element in determining price, there is no simple formula that can be applied in every case. As was recently explained in a letter from Controller Jack Rigsby to the Office of the DOD Inspector General, FPI pricing is not simply a question of costs, but must be configured to respond to our unique role as a Federal government correctional program with many statutory mandates, including requirements that we produce products on an economic basis, employ as many inmates as possible, diversify our product lines, avoid undue impact on the private sector, teach inmates a trade, and charge no more than current market price. The pressure to diversify and accomplish all these other goals, while the entire corporation remains economically self sustaining, may require that earning margins for some products be higher so that earnings on other products may be smaller or even non-existent, but we meet our other Congressional mandates. However, at no time can our price be more than current market price.

2

For these reasons, we suggest that unit cost estimates be provided where the agency requests them. In most cases, it may be sufficient to look at total material costs rather than all single items. However, whenever there is a question of whether our costs are accurate or to ensure they do not exceed current market price, we will gladly provide all details requested by the contracting officer.

It is very important to ensure our cost statements meet DOD's requirements, and we would be glad to meet with you if you think the policy set out above needs modification.

Sincerely,

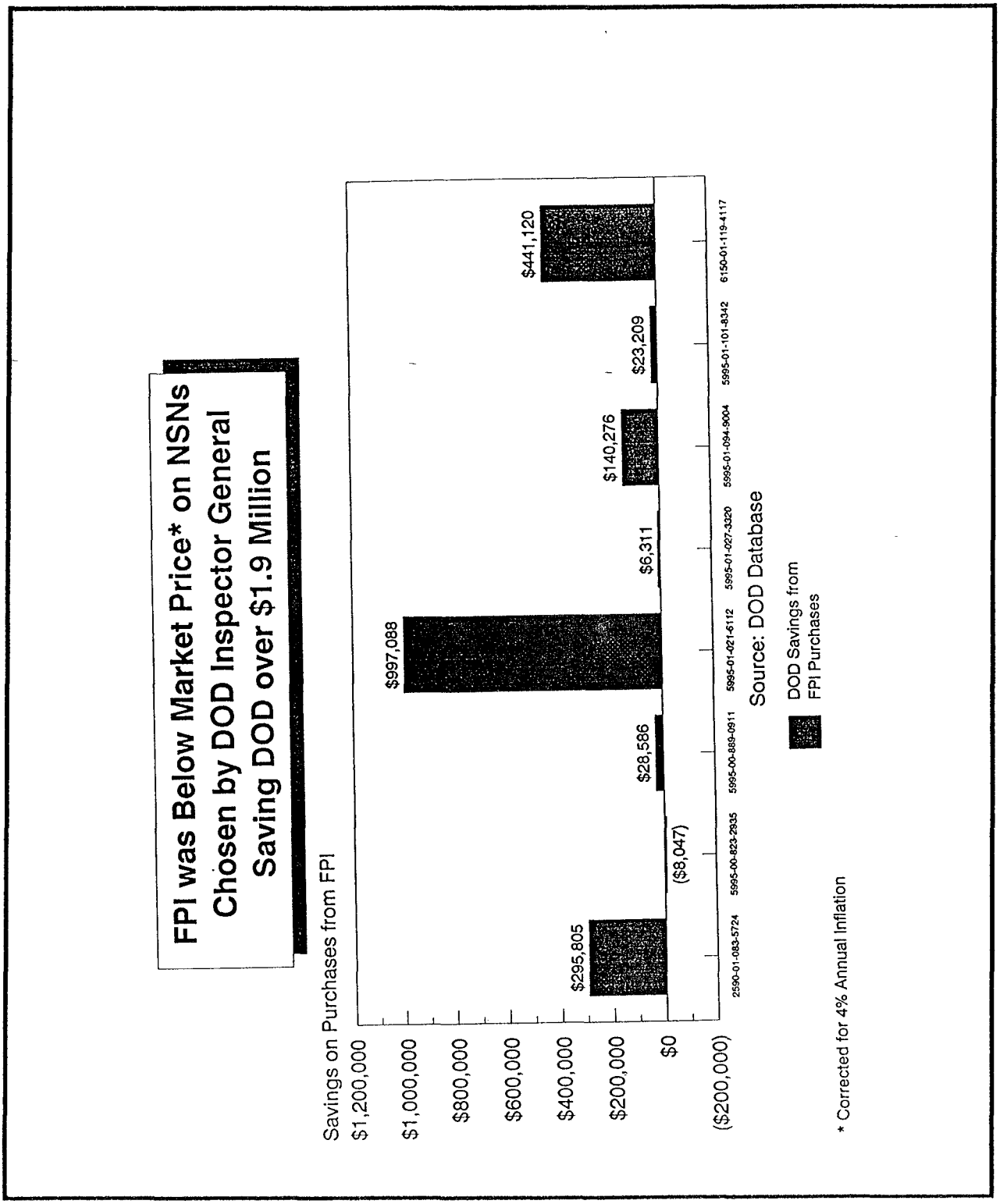
Thomas J. Pospichal
Division Manager
Plans & Policy Division

ATTACHMENT 2

FPI was Below Market Price on NSNs Chosen by DOD Inspector General Saving DOD over $1.9 Million

	Total Buys from FPI	Same Buys Using Most Recent Private Sector Price*	Resulting DOD Savings
2590-01-083-5724	$927,988	$1,223,793	$295,805
5995-00-823-2935	$118,056	$110,009	($8,047)
5995-00-889-0911	$92,646	$121,231	$28,586
5995-01-021-6112	$2,264,993	$3,262,081	$997,088
5995-01-027-3320	$33,903	$40,214	$6,311
5995-01-094-9004	$41,853	$182,128	$140,276
5995-01-101-8342	$18,305	$41,514	$23,209
6150-01-119-4117	$358,708	$799,829	$441,120
Grand Totals	$3,856,451	$5,780,799	$1,924,348

* Corrected for 4% Annual Inflation


FPI was Below Market Price* on NSNs
Chosen by DOD Inspector General
Saving DOD over $1.9 Million
Savings on Purchases from FPI
$1,200,000
$1,000,000
$800,000
$600,000
$400,000
$200,000
$0
($200,000)
$295,805
($8,047)
$28,586
$997,088
$6,311
$140,276
$23,209
$441,120
2590-01-083-5724
5995-00-823-2935
5995-00-889-0911
5995-01-021-6112
5995-01-027-3320
5995-01-094-9004
5995-01-101-8342
6150-01-119-4117
Source: DOD Database
DOD Savings from
FPI Purchases
* Corrected for 4% Annual Inflation

FPI is Below Most Recent Market Price* on NSNs Chosen by Defense Department Inspector General
Saving DOD $1.9 Million on Eight NSNs Alone

NSN	PROCUREMENT SOURCE	CAGE	CONTRACTOR	AWARD DATE	UNIT PRICE	QUANTITY	TOTAL PRICE
2590-01-083-5724	TACOM	53753	FPI	01/27/89	$1,720.81	254	$437,085.74
	TACOM	53753	FPI	04/09/87	$1,818.98	134	$243,742.97
	TACOM	53753	FPI	04/09/87	$1,844.47	134	$247,158.98
	TACOM	1417	General Dynamics Lands Systems Inc.	01/21/83	$1,965.60	224	$440,173.44
	TACOM	1417	General Dynamics Lands Systems Inc.	11/03/82	$541.72	109	$59,047.48
	TACOM	1417	General Dynamics Lands Systems Inc.	11/03/82	$1,979.70	37	$73,225.59
	TACOM	1417	General Dynamics Lands Systems Inc.	02/21/79	$1,989.75	69	$137,292.75
Average Price -				$1,694.43			
Highest Price -		General Dynamics Lands Systems Inc.		$1,989.75			
Most Recent Non-FPI Price -		General Dynamics Lands Systems Inc.		$1,965.60			
- Adjusted for Inflation to Mid-Point of FPI price dates				$2,344.43			
DOD Savings by Buying from FPI -				$295,805.42	24% Savings		
5995-00-823-2935	DGSC	54736	FPI	12/13/90	$5.73	2,080	$11,918.40
	DGSC	54736	FPI	11/12/89	$5.62	2,800	$15,736.00
	DGSC	54736	FPI	04/27/89	$5.59	4,940	$27,614.60
	DGSC	54736	FPI	03/05/89	$5.59	2,800	$15,652.00
	DGSC	54736	FPI	01/18/89	$5.60	1,908	$10,684.80
	DGSC	54736	FPI	06/11/88	$5.40	6,750	$36,450.00
	DGSC	33846	Summit Electronics Inc.	05/10/88	$4.95	1,400	$6,930.00
	DGSC	54736	FPI	11/01/87	$5.11	3,000	$15,330.00
	DGSC	54736	FPI	06/28/86	$5.40	2,854	$14,384.16
Average Price -				$5.44			
Highest Price -		FPI		$5.73			
Most Recent Non-FPI Price -		Summit Electronics Inc.		$4.95			
- Adjusted for Inflation to Mid-Point of FPI price dates				$5.17			
DOD Savings by Buying from FPI -				($8,047.26)	-7% Savings		
5995-00-889-0911	DGSC	53753	FPI	09/24/90	$57.89	481	$27,845.09
	DGSC	53753	FPI	10/04/89	$56.80	460	$25,796.80
	DGSC	53753	FPI	05/31/89	$55.72	700	$39,004.00
	DGSC	33846	Summit Electronics Inc.	08/01/88	$70.00	87	$6,090.00
	DGSC	2103	Electronic Associates Inc.	05/08/88	$85.55	65	$5,560.75
	DGSC	33846	Summit Electronics Inc.	04/16/88	$70.00	20	$1,400.00
	DGSC	50738	Wire-Pro Inc.	01/12/88	$72.00	66	$4,752.00
	DGSC	54840	Precision Cable Mfg. Co.	05/19/87	$94.30	41	$3,866.30

FPI is Below Most Recent Market Price* on NSNs Chosen by Defense Department Inspector General
Saving DOD $1.9 Million on Eight NSNs Alone

NSN	PROCUREMENT SOURCE	CAGE	CONTRACTOR	AWARD DATE	UNIT PRICE	QUANTITY	TOTAL PRICE
	DGSC	18197	Tri-State Electronics Corp.	10/13/86	$106.92	8	$855.36
	DGSC	50738	Wire-Pro Inc.	07/31/84	$160.00	4	$640.00
Average Price -				$82.92			
Highest Price -			Wire-Pro Inc.	$160.00			
Most Recent Non-FPI Price -			Summit Electronics Inc.	$70.00			
- Adjusted for Inflation to Mid-Point of FPI price dates				$73.88			
DOD Savings by Buying from FPI -				$28,585.50	24% Savings		
5995-01-021-6112	Mechanicsburg SPCC	53753	FPI	04/26/88	$814.16	2,782	$2,264,993.12
	Mechanicsburg SPCC	8718	ITT Cannon Electric	08/05/86	$1,096.84	130	$142,589.20
	Mechanicsburg SPCC	8718	ITT Cannon Electric	09/12/85	$840.18	873	$733,477.14
	Mechanicsburg SPCC	8718	ITT Cannon Electric	09/08/85	$1,580.93	27	$42,685.11
	Mechanicsburg SPCC	8718	ITT Cannon Electric	08/31/84	$873.62	3,278	$2,863,726.36
	Mechanicsburg SPCC	53753	FPI	05/16/84	$970.85	934	$906,773.90
	Mechanicsburg SPCC	8718	ITT Cannon Electric	04/02/84	$1,385.57	3	$4,156.71
	Mechanicsburg SPCC	8718	ITT Cannon Electric	12/27/83	$1,385.57	13	$18,012.41
	Mechanicsburg SPCC	74168	Office Interiors Ltd.	05/10/82	$650.41	935	$608,133.35
	Mechanicsburg SPCC	8718	ITT Cannon Electric	05/03/82	$1,195.13	29	$34,658.77
	Mechanicsburg SPCC	71468	ITT Corp.	12/08/78	$400.63	789	$316,097.07
Average Price -				$1,017.63			
Highest Price -			ITT Cannon Electric	$1,580.93			
Most Recent Non-FPI Price -			ITT Cannon Electric	$1,096.84			
- Adjusted for Inflation to Mid-Point of FPI price dates				$1,172.57			
DOD Savings by Buying from FPI -				$997,088.37	31% Savings		
5995-01-027-3320	DGSC	54736	FPI	03/17/89	$51.47	125	$6,433.75
	DGSC	65241	FPI	11/19/87	$52.72	150	$7,908.00
	DGSC	65241	FPI	08/10/87	$52.21	100	$5,221.00
	DGSC	65241	FPI	03/23/87	$51.34	150	$7,701.00
	DGSC	65241	FPI	12/20/86	$51.70	130	$6,639.10
	DGSC	5234	Baird Corp	01/31/82	$50.00	89	$4,450.00
Average Price -				$51.57			
Highest Price -			FPI	$52.72			
Most Recent Non-FPI Price -			Baird Corp	$50.00			
- Adjusted for Inflation to Mid-Point of FPI price dates				$61.40			

FPI is Below Most Recent Market Price* on NSNs Chosen by Defense Department Inspector General
Saving DOD $1.9 Million on Eight NSNs Alone

NSN	PROCUREMENT SOURCE	CAGE	CONTRACTOR	AWARD DATE	UNIT PRICE	QUANTITY	TOTAL PRICE
DOD Savings by Buying from FPI -				$6,310.92	16% Savings		
5995-01-094-9004	DGSC	53753	FPI	08/11/89	$43.79	681	$29,820.99
	DGSC	53753	FPI	09/23/87	$66.46	49	$3,256.54
	DGSC	53753	FPI	08/29/86	$65.00	135	$8,775.00
	DGSC	3640	IBM	05/01/85	$190.24	1	$190.24
Average Price -				$91.37			
Highest Price -	IBM			$190.24			
Most Recent Non-FPI Price -	IBM			$190.24			
- Adjusted for Inflation to Mid-Point of FPI price dates				$210.55			
DOD Savings by Buying from FPI -				$140,275.91	77% Savings		
5995-01-101-8342	DGSC	54736	FPI	04/12/90	$35.10	159	$5,566.59
	DGSC	54736	FPI	03/22/89	$34.70	160	$5,552.00
	DGSC	65241	FPI	04/29/87	$46.67	60	$2,800.20
	DGSC	65241	FPI	02/03/87	$46.67	50	$2,333.50
	DGSC	65241	FPI	03/03/86	$45.62	45	$2,052.90
	DGSC		Gull Industries, Inc.	08/01/84	$77.00	81	$6,237.00
	F336577	98897	Lockheed Aeronautical	01/02/78	$67.89	1	$67.89
Average Price -				$50.52			
Highest Price -	Gull Industries, Inc.			$77.00			
Most Recent Non-FPI Price -	Gull Industries, Inc.			$77.00			
- Adjusted for Inflation to Mid-Point of FPI price dates				$87.58			
DOD Savings by Buying from FPI -				$23,208.54	56% Savings		
6150-01-119-4117	TACOM	53753	FPI	08/25/89	$387.10	229	$88,625.29
	TACOM	53753	FPI	08/25/89	$383.14	458	$175,478.12
	TACOM	53753	FPI	01/22/87	$378.42	250	$94,605.00
	TACOM	1417	General Dynamics Land Systems Inc.	09/30/82	$687.44	20	$13,748.80
Average Price -				$459.03			
Highest Price -	General Dynamics Land Systems Inc.			$687.44			
Most Recent Non-FPI Price -	General Dynamics Land Systems Inc.			$687.44			
- Adjusted for Inflation to Mid-Point of FPI price dates				$853.61			
DOD Savings by Buying from FPI -				$441,120.28	55% Savings		

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Saving DOD $1.9 Million on Eight NSNs Alone

NSN	PROCUREMENT SOURCE	CAGE	CONTRACTOR	AWARD DATE	UNIT PRICE	QUANTITY	TOTAL PRICE

* Using 4% Annual Inflation Adjustments for Most Recent Private Sector Price to Adjusted to Mid-Point of Purchase Dates from FPI.

			TOTAL DOD SAVINGS BY BUYING FROM FPI ON THE ABOVE NSNs		-		$1,924,347.69

List of Audit Team Members

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Catherine M. Schneiter, Team Leader
Frederick R. Mott, Auditor
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