Audit Report

OFFICE OF THE INSPECTOR GENERAL

CONTRACTING OFFICER PRICE ANALYSES

Report No. 94-004 October 15, 1993

Department of Defense

Acronyms

AFMC	Air Force Materiel Command
AFPRO	Air Force Plant Representative Office
ASO	Aviation Supply Office
DCMAO	Defense Contract Management Area Operations
DCMC	Defense Contract Management Command
DLA	Defense Logistics Agency
DPRO	Defense Plant Representative Office
FAR	Federal Acquisition Regulation
IGCE	Independent Government Cost Estimate
SUPSHIP	Supervisor of Shipbuilding, Conversion, and Repair, Navy

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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October 15, 1993

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Contracting Officer Price Analyses (Report No. 94-004)

We are providing this final report for your information and use. The report discusses contracting officer price analyses. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that audit recommendations be resolved promptly. The Army and Navy comments were not responsive to the recommendations. Based on management comments, we redirected a recommendation to the Deputy Under Secretary of Defense (Acquisition Reform). Accordingly, we request additional comments from the Army on Recommendation 1., from the Navy on Recommendations 1. and 2., and from the Deputy Under Secretary of Defense (Acquisition Reform) on Recommendation 3. by December 14, 1993.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Richard B. Jolliffe, Program Director, at (703) 692-2999 (DSN 222-2999) or Mr. Timothy J. Staehling, Project Manager, at (703) 692-3012 (DSN 222-3012). Appendix G lists the distribution of this report.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-004 **October 15, 1993**
(Project No. 2CA-0071)

CONTRACTING OFFICER PRICE ANALYSES

EXECUTIVE SUMMARY

Introduction. Federal Acquisition Regulation 15.805, "Proposal Analysis," provides that contracting officers perform price analyses on contractor proposal prices to ensure that the overall price offered is fair and reasonable. Price analyses should be performed even when cost or pricing data are required. When cost or pricing data are not required, price analyses are mandatory. With the December 1990 change in the cost certification threshold for cost or pricing data from $100,000 to $500,000, an increased number of proposals will require only price analyses. Approximately 25,000 noncompetitive contract actions ($5.5 billion) between $100,000 and $500,000 were awarded during FY 1992. Therefore, proposals between $100,000 and $500,000 should only be evaluated by price analyses unless the contracting officer determines that obtaining certified cost or pricing data are justified. When certified cost or pricing data are not required, the contracting officer may request partial or limited data to determine a reasonable price. However, price analyses are still required.

Objectives. The primary audit objective was to determine whether contracting officer price analysis techniques used in evaluating contractor proposal prices were appropriately utilized, adequately detailed, and properly documented in the contracting records. We also evaluated the adequacy and effectiveness of internal controls over the use and documentation of price analysis techniques.

Audit Results. DoD contracting officers did not always perform and adequately document the use of price analyses on contractor proposal prices. Review of 190 FY 1992 negotiated contractual actions valued at $862.5 million at a total of 12 Army, Navy, Air Force, and Defense Logistics Agency contracting and contract administration activities showed that 85 of the 190 contractual actions ($748.7 million) contained no evidence that a price analysis was performed. Also, price analyses were not adequately documented in the Government negotiation memorandums for 33 of the 105 contractual actions ($18.9 million) where contracting officers performed price analyses. In 21 of the 190 contractual actions, price negotiation memorandums were missing from the contract records reviewed. As a result, assurance was inadequate that fair and reasonable prices were obtained in all instances for negotiated contractual actions. Further, contractor and Government resources were not used economically when detailed cost or pricing data were obtained for 97 of 116 contractual actions under $500,000, and were only certified for 32 of the actions. The audit results are not projectable. See the finding in Part II for details.

Internal Controls. The audit did not identify any material internal control weaknesses. See Part I for the internal controls assessed.

Potential Benefits of Audit. The report recommendations should produce future monetary benefits from reduced contract prices through the increased use and documentation of price analysis on all negotiated contractual actions. Also, decreased requests for contractor provided cost or pricing data would result in reduced use of contracting resources. However, we could not quantify the potential monetary benefits. A summary of the potential benefits resulting from the audit is in Appendix E.

Summary of Recommendations. We recommended that the Military Departments and Defense Logistics Agency issue written internal control objectives and techniques to verify performance of price analyses and documentation by contracting officers and implement guidance for determining those contractual actions for which certified cost or pricing data are required (detailed cost analyses are performed) when evaluating proposals under $500,000. We also recommended that the Deputy Under Secretary of Defense (Acquisition Reform) restructure the current training requirements for price analysis to emphasize the performance and documentation of price analysis techniques.

Management Comments. The Air Force and the Defense Logistics Agency agreed to implement the recommendations. The Army and Navy stated that current guidance on price and cost analyses was adequate and that implementing the recommendations was not needed because the report did not accurately reflect current contracting officers' pricing practices. The Director of Acquisition Education, Training, and Career Development, Office of the Under Secretary of Defense for Acquisition, requested that the recommendation concerning restructuring training requirements be redirected to the Deputy Under Secretary of Defense (Acquisition Reform). A summary of management comments is in Part II and the complete text of management comments is in Part IV of the report.

Audit Response. We continue to believe that implementation of the recommendations would improve the Army and Navy contracting officers' pricing practices and would result in reduced contracting costs to the Government and to contractors. As requested, we redirected the recommendation concerning restructuring training requirements to the Deputy Under Secretary of Defense (Acquisition Reform). We request comments from the Army, the Navy, and the Deputy Under Secretary of Defense (Acquisition Reform) by December 14, 1993.

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This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate (703) 614-6303 (DSN 224-6303).

Part I - Introduction

Background

A "price analysis" is the process of examining and evaluating a proposal price without evaluating its separate cost elements and proposed profit. However, a cost analysis is the evaluation of each cost element, including profit, in a contractor proposal. Price analyses involve such techniques as comparing historical contract prices, market prices, commercial catalog prices, or independent Government estimates. Price analyses should be performed on all contractual actions, even those actions where cost analyses (analysis of individual cost elements and profit) are required. When cost or pricing data are not required, price analyses are mandatory. Federal Acquisition Regulation (FAR) 15.805-2, "Price Analysis," states the contracting officer is responsible for selecting and using whatever price analysis techniques ensure an overall fair and reasonable price for the Government.

Public Law 101-510, "FY 1991 National Defense Authorization Act," Section 803, amended Title 10, United States Code, Section 2306a(a)(1) to increase the threshold for submission of cost or pricing data from $100,000 to $500,000. DoD implemented the threshold change on December 5, 1990. Congress mandated the $500,000 threshold with a "sunset" clause providing for the law's expiration after December 31, 1995, at which date the $500,000 threshold returns to $100,000. Cost or pricing data can be either certified or not certified. Contractor certified cost or pricing data are subject to price reductions for defective data under Title 10 U.S.C. Section 2306a, "Cost or Pricing Data: Truth In Negotiations," when the cost or pricing data are determined to be inaccurate, incomplete and noncurrent.

In a December 5, 1990, memorandum, "Increase in Cost or Pricing Data Threshold," the Director of Defense Procurement notified contracting offices to consider requiring cost or pricing data for contract proposals below the $500,000 threshold in situations where contractors had recently used fraudulent cost estimating or accounting practices, had significant estimating system deficiencies, or were the subject of recent and significant findings of defective pricing. When certified cost or pricing data were not required, contracting officers could require the submission of partial or limited cost data if considered necessary to ensure price reasonableness.

In a May 29, 1992, memorandum, "Certified Cost or Pricing Data," the Director of Defense Procurement reiterated and clarified the guidance in the December 5, 1990, memorandum, directing the contracting offices to perform a price analysis to ensure price reasonableness when cost or pricing data were not obtained. The May 29, 1992, memorandum also discussed the use of price analysis techniques and data sources that contracting officers could use to ensure price reasonableness. See Appendix A for complete text of both memorandums. As a result of the change in the cost certification threshold from $100,000 to $500,000, contractor proposals priced under $500,000 should normally only be subjected to price analysis instead of cost analysis. Therefore, application of proper price analysis techniques by contracting officers is more significant.

Objectives

The primary audit objective was to determine whether contracting officer price analysis techniques, used in evaluating contractor proposals, were appropriately utilized, adequately detailed, and properly documented in the contracting records. We also evaluated the adequacy and effectiveness of internal controls over the use and documentation of price analysis techniques to determine whether the interests of the Government were protected.

Scope

Judgmental Sample and Audit Locations. The initially planned statistical sample could not be selected due to the existence of numerous errors in various contractual data base sources. In lieu of using a statistical sample, we judgmentally selected 190 FY 1992 negotiated contractual actions ($862.5 million) at a total of 12 Army, Navy, Air Force, and Defense Logistics Agency (DLA) contracting and contract administration activities (Appendix B). As discussed under "Prior Audits and Other Reviews," the Air Force Audit Agency performed a review of selected Air Force Logistics Command (now Air Force Materiel Command [AFMC]) activities. The Air Force Audit Agency concluded that certain AFMC air logistics centers did not accomplish adequate price analyses. Therefore, the air logistics centers were excluded from our judgmental sample of contractual actions.

The sampled contractual actions were reviewed to determine:

o whether price analyses were performed and properly documented in the contracting files, and

o whether internal controls and training requirements covering the use and documentation of price analysis techniques were effective.

At each activity, we judgmentally selected FY 1992 sole-source negotiated contractual actions in excess of $100,000 (with and without certified cost or pricing data). We reviewed FY 1992 contracting documents including contractor proposal data and certifications; technical, Defense Contract Audit Agency, and price analysis reports; and both pre- and post-negotiation memorandums. We also interviewed Government contracting officers, contract administrators, negotiators, price-cost analysts, and financial services personnel. We relied on FY 1992 computer-generated data from a number of sources to judgmentally select a sample of contractual actions. The primary sources included the DD Form 350, "Individual Contracting Action Report," various contract pricing case data bases, and selected internal contract data bases. All of these data base sources contained numerous errors that were identified when reviewing the selected contractual files. The errors were corrected by selecting replacement contractual actions and requesting the contracting offices to prepare accurate data base listings during the audit.

Audit Period and Standards. We performed this economy and efficiency audit from September 1992 through April 1993 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as were considered necessary. Appendix F lists the activities visited or contacted during the audit.

Internal Controls

We evaluated internal controls covering the use and documentation of price analyses in selected sole-source negotiated procurements. At each of the 12 selected DoD activities, we analyzed the stated internal control objectives and reviewed the adequacy of the techniques used to accomplish the stated objectives. We reviewed the 12 DoD activities most recent available risk assessments and Internal Control Management Programs to ascertain if price analysis techniques were included and to determine if the coverage was sufficient to verify the performance of price analyses. We also reviewed contract files and interviewed DoD procurement and contracting personnel. Our review of the DoD activities assessments was performed in accordance with the Federal Managers' Financial Integrity Act as implemented by Office of Management and Budget Circular A-123. The audit disclosed no material internal control deficiencies related to contracting officer price analyses.

Prior Audits and Other Reviews

Since 1987, the Office of the Inspector General, DoD, has issued two final reports concerning the use of price analyses. The General Accounting Office, the Navy, and the Air Force have also issued reports covering the use of price analyses to evaluate both prime and subcontract proposal prices. The recommendations in this report address internal control weaknesses that are different from what was recommended in prior audit reports and other reviews addressing the use of price analyses. A summary of the reports is shown in Appendix C.

Part II - Finding and Recommendations

Price Analyses Performance and Documentation

Contracting officers did not properly perform or adequately document the use of price analyses to determine whether contractor proposal prices were fair and reasonable. A review of 190 FY 1992 negotiated contractual actions ($862.5 million) showed that 85 contractual actions ($748.7 million) contained no evidence that a price analysis was performed. Also, the price analyses that were performed were not adequately documented in the Government negotiation memorandums for 33 of 105 contractual actions valued at $18.9 million, where contracting officers performed price analyses. In 21 of the 190 contractual actions, price negotiation memorandums were missing from the contract records reviewed.

The inadequate performance and lack of documentation occurred for the following reasons:

o DoD contracting officers relied on cost analyses in evaluating proposals for 88 of 116 contract actions under $500,000 when use of cost analysis was not required or adequately justified.

o DoD contracting officers obtained detailed cost or pricing data for 97 of the 116 contractual actions priced under $500,000, whereas the cost or pricing data were only certified for 32 of the 97 actions.

o Internal controls covering the performance and documentation of price analysis techniques needed improvement at 7 of the 12 activities reviewed.

o DoD contracting officers were not aware of changes in or did not fully comply with regulations covering the proposal evaluation process and did not use or were unaware of various price analysis techniques.

o Training for the performance and documentation of price analysis techniques was not adequate for contracting personnel.

As a result, assurances that fair and reasonable prices were obtained in all instances for negotiated contractual actions were inadequate. Also, contractor and Government resources were not used economically when detailed cost or pricing data were obtained for actions priced under $500,000 and then were not certified.

Background

The contracting officer is responsible for ensuring that a contractor's proposal price is fair and reasonable. FAR 15.805, "Proposal Analysis," provides that the contracting officer should perform a price analysis of the proposal to ensure that the overall price offered is fair and reasonable. Price analyses should be performed on all contractual actions, even those actions where cost analyses are used, such as when certified cost or pricing data are required. A price analysis is defined as the process of examining and evaluating a proposal price without evaluating its separate cost elements and profit. In contrast, a cost analysis is defined as the evaluation of each cost element, including profit, in a contractor proposal. Price analyses involve such techniques as the comparison of the proposal price to historical contract prices, market prices, commercial catalog prices, or independent Government cost estimates.

As a result of the December 1990 change of the cost or pricing data certification dollar threshold from $100,000 to $500,000, the number and value of contractor proposals not subject to cost analyses increased. Approximately 25,000 noncompetitive contract actions ($5.5 billion) negotiated between $100,000 and $500,000 were awarded during FY 1992. Therefore, proposals priced under $500,000 will normally be evaluated by price analyses and the application of proper price analysis techniques by contracting officers will become more significant.

Price Analyses

The audit of 190 contractual actions negotiated for $862.5 million at 12 DoD procurement and administrative contracting offices showed that contracting officers did not perform price analyses to determine whether the contractor proposed prices were fair and reasonable. DoD contracting officers did not perform price analyses to evaluate contractor proposals before performing further cost analyses to develop the negotiation objective for 85 of 190 contractual actions reviewed (Appendix B). As a result, assurances that fair and reasonable prices were obtained in all instances for negotiated contractual actions were inadequate.

Limited Price Analyses. For contract actions reviewed at DLA and Air Force activities, price analyses were limited. Price analyses were not performed for 55 of the 90 DLA contract actions and for 17 of the 22 Air Force actions reviewed. The Army and Navy performed price analyses substantially better than the Air Force and DLA. Price analyses were not performed for 5 of 29 Army contract actions and not performed for only 8 of 49 Navy actions reviewed.

At DLA activities, price analysis performance was substantially limited at Defense Contract Management Command (DCMC) activities. Price analyses were not performed for 49 of 65 contract actions negotiated at 5 DCMC activities reviewed. For example, only 2 of 20 contract actions reviewed at

Defense Contract Management Area Operations (DCMAO), El Segundo, and 1 of 15 actions reviewed at the Defense Plant Representative Office (DPRO), General Dynamics, Fort Worth, included the performance of a price analysis. In none of the three instances were price analyses used to substantiate that the proposed price was fair and reasonable.

Determination of Fair and Reasonable Offered Price. Even where contracting officers are performing cost analyses, price analyses are also needed to determine the reasonableness of the proposed price. For example, DCMAO, El Segundo, contract personnel negotiated contract F04606-90-G-0042-GB22 with Rockwell International for the purchase of B-1B bomber fairings. Review of the contract file indicated that the fairings were purchased from Rockwell International in November 1989 at $767 per unit. However, Rockwell International initially quoted the fairings at $1,760 per unit in November 1990, and again proposed the fairings at $2,505 per unit in August 1992. The order was negotiated in September 1992 for 54 fairings at $2,491 a unit, for a total of $134,514. The large disparity between the previous price and the negotiation objective of $2,476 per unit was not mentioned in the price negotiation memorandum. The negotiator/price analyst only stated that a cost analysis review of supporting Rockwell International cost or pricing data was the basis for the negotiated price.

In another example, the Navy Aviation Supply Office (ASO), Naval Supply Systems Command, awarded contract N00383-92-C-A127 in June 1992, with MPC Products Corporation for 21 electro-mechanical actuators at $8,850 per unit, for a total price of $185,850. The contract negotiator based the procurement on an in-house cost analysis of uncertified contractor cost or pricing data. A negotiated reduction to the proposed price was not achieved. The negotiation memorandum stated that a price analysis was not possible as no previous procurement history was available. The ASO computer records indicated that the actuators were procured on seven occasions from September 1985 to June 1988 at prices ranging up to $3,206 per unit, 64 percent less than the 1992 procurement price.

Requirement for Price Analyses. DoD contracting officers did not perform a price analysis because the contracting officers were excessively relying on cost analyses in evaluating proposals under $500,000. In addition, DoD contracting officers did not comply with FAR 15.805 that contracting officers should perform a price analysis for all contractual actions to ensure that the contractor-proposed price was fair and reasonable. DoD contracting officers believed that a cost analysis was sufficient even though the cost or pricing data reviewed were uncertified.

Price Analysis Documentation

For 33 of the 105 contract actions where contracting officers performed price analyses, the price analysis technique used was not adequately documented in the negotiation memorandum. Failure to document the negotiation memorandum with the price analysis technique performed was more significant

at Navy and DLA activities than at Army and Air Force activities reviewed. The Navy did not adequately document 18 of 41 contract actions, and DLA did not document 11 of 35 actions when price analyses were performed. The Army did not adequately document in the negotiation memorandum for 3 of 24 contract actions, and the Air Force did not adequately document 1 of 5 contract actions when price analyses were performed. The lack of documentation does not provide assurance that proposed prices were properly evaluated, adequately supported, and determined to be fair and reasonable.

Documentation Techniques. FAR 4.801, "General," requires contracting officers to include sufficient documentation in the contract files to demonstrate a complete history of the contracting process. DoD contracting officers did not adequately document the contract records to explain the price analysis technique used to determine that the proposed price was fair and reasonable for 33 contract actions ($18.9 million). Contracting officers did not document the details for their price analyses because the evaluation of the proposed prices in determining the negotiation objective was based on cost analyses.

Documentation in a Separate Section of the Negotiation Memorandum. Army and Navy negotiation memorandums more often included documentation sections for price analysis than did corresponding Air Force and DCMC memorandums. For example, Navy ASO negotiation memorandums included sections designated for documentation of price comparisons to previous procurements and the results of alternative price reasonableness techniques. As a result, 13 of the 15 ASO negotiation memorandums included at least some documentation that price analysis techniques were used.

Although the Army and the Navy used negotiation memorandums that included a separate section for the discussion of price analyses, contracting officers did not always adequately document the details of the price analyses performed. For example, in three instances, contracting officers at the Army Missile Command stated in the negotiation memorandum that the price was fair and reasonable but did not record the detail of the price analysis performed. In another example, contracting officers at the Supervisor of Shipbuilding, Conversion, and Repair, Navy, (SUPSHIP), San Diego, stated in the negotiation memorandums for 6 of the 20 contract actions reviewed that various price analysis techniques were performed. The contracting officers documented that price analysis techniques such as price comparisons of similar work, historical data costs, established catalog, or market prices were performed to determine that the proposed price was fair and reasonable. However, SUPSHIP, San Diego, contracting officers did not adequately record the supporting details for the techniques performed to determine that proposed prices were fair and reasonable.

Air Force and DCMC negotiation memorandums did not include separate sections designated to document the results of price analyses performed. As a result, price analyses, if performed, were not recorded within the scope of the negotiation objectives. For example, none of the 40 negotiation memorandums prepared at DCMAO, El Segundo; DCMAO, Atlanta; or DPRO, General Dynamics, Fort Worth, included a discussion of price analysis techniques used or a discussion of why price analyses could not be performed.

In Report No. 91064045, "Negotiation of Noncompetitive Acquisitions from $100,000 to $500,000," July 29, 1990, the Air Force Audit Agency recommended that AFMC establish standard contract file documentation for price analyses. As a result of the recommendation, AFMC prepared a new negotiation memorandum format (Appendix D) for contracting officers to use when evaluating a contract action using price analyses. The Air Force distributed the new negotiation memorandum format to all field activities in March 1993. In our opinion, the use of the new AFMC negotiation format or a comparable version included as a separate section of the negotiation memorandum for all contract actions should ensure compliance with FAR requirements on price analyses.

Negotiation Memorandum Documentation. In 21 of the 190 contractual actions, price negotiation memorandums were missing from the contract records reviewed. Where price analyses (85 contract actions) were not performed, a negotiation memorandum was missing from 13 of the contract records. The 13 missing negotiation memorandums were at 2 separate DLA activities.

Where price analyses (105 contract actions) were performed, the negotiation memorandums were missing from 6 Navy (ASO) and 2 DLA contract records. Navy and ASO personnel stated that including negotiation memorandums in the written contract files was not necessary, as equivalent documentation was contained in the ASO contracting computer files. However, ASO could not provide a written policy or procedure detailing the use and documentation of computer-based contracting files. We found that while contract summaries and analyses (including price analyses), were in the computer files, the computer files did not meet the 10 minimum information requirements of FAR 15.808, "Price Negotiation Memorandum." For example, the computer files did not include information that supported the basis for the contracting officer decision to award the procurement such as a summary of assist audits, cost analyses, contractor purchasing system analysis, and the basis for determining profit.

Cost Analysis

Contracting officers relied on cost analyses as the primary proposal analysis technique for contract actions valued between $100,000 and $500,000 at 10 of the 12 activities reviewed. Only ASO and the Defense Personnel Support Center, Defense Logistics Agency, used price analyses as the primary proposal analysis technique for contract actions under $500,000.

Reliance on Cost Analyses. DoD contracting officers placed greater reliance on the performance of cost analyses than price analyses in developing negotiation objectives for actions valued between $100,000 and $500,000 despite the threshold change. DoD contracting officers used cost analyses for 88 of the 116 contractual actions reviewed between $100,000 and $500,000 to determine the negotiation objective. Detailed cost or pricing data were provided for 97 of the 116 contractual actions reviewed. Contracting officer negotiation teams prepared 67 of the 88 cost analyses. The Financial Services Branch offices, DCMC, performed the remaining 21 of the 88 cost analyses as a result

of contracting officer field pricing requests. Contracting personnel relied more on the performance of cost analyses because of their reluctance to change from the use of cost analysis in evaluating proposals under $500,000, although the threshold for certified cost or pricing data was increased to $500,000.

For example, at DCMAO, Atlanta, administrative contracting officers did not perform any price analysis techniques in establishing a price objective for 12 negotiated contract actions, including 7 actions valued between $100,000 and $500,000. Three DCMAO, Atlanta, contracting teams were assigned negotiation authority for each of three simultaneous multiple-source procurements of similar desert combat boots from different boot manufacturers. The contracting teams did not compare the unit pricing of proposals from the different manufacturers, available in the contracting records. Each procurement was negotiated solely on the basis of a cost analysis of the individual boot manufacturer's proposal.

On December 5, 1990, as a result of the threshold change, the Director of Defense Procurement issued guidance describing those situations requiring cost or pricing data in evaluating proposals under $500,000. The guidance provides that contracting officers should require certified cost or pricing data for contract proposals below the $500,000 threshold in situations where contractors had recently used fraudulent cost estimating or accounting practices, had significant estimating system deficiencies, or were the subject of recent and significant findings of defective pricing. Contrary to the intent of the guidance, most contracting officers obtained detailed cost or pricing data when the data were not required and performed a cost analysis to determine the Government negotiation objective. Also, the Military Departments and DLA did not effectively communicate the guidance to their contracting officers.

Although contracting officers obtained detailed cost or pricing data for 97 of the 116 actions priced under $500,000, the cost or pricing data were only certified in 32 of the 97 instances. Contractor and Government resources are not used economically when detailed cost or pricing data are obtained when not required for actions priced under $500,000. The contracting officer is required to determine in writing that cost or pricing data are necessary to evaluate the reasonableness of the contractor or subcontractor proposed price. Also, if cost or pricing data are required to evaluate the reasonableness of the proposed price, then the contracting officer should require the contractor to certify the data.

Certified Cost or Pricing Data. Contracting personnel were not always aware that the threshold for certified cost or pricing data was increased to $500,000. A certification of cost or pricing data was received from the contractor for 32 of the 116 reviewed actions under $500,000. Only 7 of 32 instances justified a valid need to obtain certified cost or pricing data based on criteria in the 1990 and 1992 Director of Defense Procurement memorandums (Appendix A). The DPRO, General Dynamics, Fort Worth, requested and obtained certification of cost or pricing data from the contractor for all actions over $100,000 because contractual clauses on existing contracts were not modified to incorporate the threshold change for actions under $500,000.

Further, for 10 of the 116 actions valued between $100,000 and $500,000, the contracting officer requested an audit on the proposal costs. In each of the 10 actions the contracting officer used the audit of proposal costs in determining the negotiation objective.

Contracting officers at Defense Contract Management Districts South and West stated they had not changed their techniques of proposal analysis to determine whether a price was fair and reasonable for contractual actions valued between $100,000 and $500,000. Contracting officers continued to rely on the same amount of cost or pricing data as they had before the threshold change and continued to conduct negotiations primarily on a cost analysis basis. For example, in July 1992, DPRO, General Dynamics, Fort Worth, negotiated contract F42600-83-C-4011, order PM0967, for $105,769 to procure two spare parts for an F-16 aircraft using cost or pricing data. The negotiation documentation did not indicate that a price analysis was considered.

Contract negotiators unaware of the threshold change continued to request and receive certificates for cost or pricing data for procurements under $500,000. For example, in January 1992, DCMAO, Atlanta, definitized contract DLA100-91-C-0378, modification P00002, for $120,704 to procure desert combat fatigues. The negotiator was under the mistaken impression that cost or pricing data needed to be certified since the negotiations were performed on a cost analysis basis.

Internal Controls

Internal control procedures over the performance and documentation of price analyses needed improvement at 7 (2 Navy, 1 Air Force, and 4 DCMC) of the 12 reviewed activities. The price analysis process was not designated as a separate assessable control unit subject to periodic reviews at any of the seven activities. Periodic reviews were not sufficiently undertaken to ensure the use of price analysis as a technique, or that the price analysis was properly documented in the negotiation memorandums.

For example, during the past 5 years DCMAO, Atlanta, and DPRO, General Dynamics, Fort Worth, have not performed internal control reviews that assessed the use of price analysis. Both DCMAO, Atlanta, and DPRO, General Dynamics, Fort Worth, substituted cost analyses instead of price analyses as the primary proposal analysis tool for contract actions valued between $100,000 and $500,000. Government personnel contended that negotiation objectives developed from cost analyses lengthened the negotiation process; however, cost analyses still reduced the risk that an internal control weakness would result in a substantial loss to the Government.

Three Defense Contract Management District West field activities were implementing a new 5-year plan for internal control reviews starting in FY 1993. The new 5-year plan designates an assessable unit (called an event cycle) to financial services branches for the coverage of "price/cost analysis." However, since a price analysis is not generally performed by financial services

branches, the review of a cost analysis was the actual assessable unit rather than both cost and price analyses. In addition, the Defense Contract Management District West plan does not include a price analysis event cycle for the Federal Managers' Financial Integrity Act review of contract operation and negotiation functions.

Knowledge of Price Analysis Techniques

Contracting officers and contract negotiators lacked knowledge of price analysis techniques as detailed in the Armed Services Pricing Manual. Specifically, contracting personnel did not know what price analysis was required if no price analysis had previously been performed or if price/cost analysis was performed by an analyst who was not part of the immediate negotiation team. For example, contracting personnel at DCMAO, Atlanta; DCMAO, El Segundo; and DPRO, General Dynamics, Fort Worth, were not aware of specific price analysis techniques detailed in the Armed Services Pricing Manual. We observed three different price analysis techniques that contracting officers generally used. These techniques are described below.

Historical Price Comparisons. The most common form of price analysis technique used was a comparison to historical costs. This technique was generally performed at major procurement activities. For example, ASO used a historical price analysis for 21 of the 23 actions reviewed. The Defense Personnel Support Center performed price analyses that included at least a history-based analysis in 19 of 25 cases reviewed.

Historical price comparisons were inadequate because the price comparison was only made to the most recent procurement of an item from the same manufacturer. For example, there were seven sole-source ASO contract actions valued between $100,000 and $500,000 for which the performance of price analysis alone was questionable. In these seven ASO actions, no cost or pricing data were requested or received, no negotiations were held, and no proposal reductions were achieved. Also, ASO negotiators did not review previous contract files to find out whether prior prices were determined to be fair and reasonable. Contract records, which were available for the 5 years preceding the dates of these procurements, showed no price reductions. In only one instance was a previous procurement price supported by certified cost or pricing data. Prior prices in two other procurements were based on uncertified cost or pricing data. For two other procurements, no cost or pricing data were submitted in the past 5 years, and for the two remaining procurements ASO could not locate the prior contract records.

An example of one of the seven ASO pricing actions with questionable price analysis was contract N00383-92-C-U214. The contract was awarded in July 1992 to Signal Design, Incorporated, for 26 recorder-reproducers at $9,045 per unit, for a total price of $235,170. The contract negotiator accepted the contractor proposal based on a price comparison to a previous buy 10 months earlier from Signal Design, Incorporated, at $9,085 per unit. The

contract negotiator and the procurement contracting officer stated they did not review the previous procurement contract file.

Independent Government Cost Estimates. One price analysis technique that contracting officers used to determine that contractor proposed prices were fair and reasonable was the comparison of proposed prices with independent Government cost estimates (IGCE). We found that IGCEs were sometimes prepared but were often not used in determining that the proposed price was fair and reasonable. Only 2 of the 12 DoD activities prepared IGCEs. For example, the Army Missile Command generally prepared IGCEs and documented the results in the negotiation memorandum and contract records. Our review of 19 Army Missile Command contract actions showed that for 7 contract actions, IGCEs were prepared but were not used to determine if the proposed price was fair and reasonable.

The other location at which IGCEs were prepared was at SUPSHIP, San Diego. IGCEs were prepared for both new construction and conversion and repair contractual efforts. For 5 of the 20 SUPSHIP, San Diego, contract actions reviewed, IGCEs were prepared but were not used by the contracting officer to determine whether the proposed price was fair and reasonable. The majority of the prepared IGCE amounts were lower than the contractor proposal amounts, and SUPSHIP, San Diego, contracting personnel were not relying on the IGCEs to determine the negotiation objectives. On one contract action, modification EH68/A00740 issued under contract N00024-85-H-8221, the IGCE, which was unsigned and undated, appeared to have been prepared after receipt of the contractor proposal. In this instance, the IGCE amount of $1,438,420 was $798 more than the contractor-proposed amount of $1,437,622 and was only included as part of the post-negotiation memorandum.

Value Analysis Techniques. Contract personnel at former Air Force Plant Representative Office (AFPRO) activities performed a form of price analysis entitled "Value Review." The objective of the value review was to determine whether the quoted price for spare parts and support equipment items exceeded 25 percent or more of the lowest price the Government had paid for such items within the previous 12-month period. The value review included an intrinsic value analysis of drawings the contractor provided and a review of price history maintained on the Air Force Acquisition Management Information System data base.

Value reviews were discontinued at three of the four former AFPRO activities after they were absorbed into DCMC and renamed DPROs. For example, the AFPRO system price history data base for AFPRO, Rockwell, Los Angeles, was discontinued after the AFPRO, Rockwell, Los Angeles, was merged into the DCMAO, El Segundo, office in September 1991. Value reviews at AFPRO, Northrop, Hawthorne, and AFPRO, General Dynamics, Fort Worth, were also discontinued after conversion of the AFPROs to DPROs. However, DPRO, Hughes, Los Angeles, continued to perform value reviews after the conversion of AFPROs to DPROs.

Value reviews are not a DLA requirement. However, DLA Manual 8105.1, "Defense Contract Management Command Contract Administration Manual,"

October 1990, section 15.805-3b(3)(e), requires the DCMC price/cost analysts to use the Air Force Acquisition Management Information System data base or any other data base maintained by DoD, as well as other available cost information that can be useful in evaluating the reasonableness of the contractor proposals.

Price Analysis Training

In DoD, price analysis training is limited to courses that contain training primarily devoted to cost analysis. The required DoD courses for acquisition personnel presently do not emphasize the performance and documentation of price analysis techniques. For example, the DoD training course "Principles of Contract Pricing," content includes:

> an estimation of the environment in which cost and price analysis takes place, sources of data for cost and price analysis, methods for analyzing direct and indirect costs, performing profit analysis, and selected current pricing topics. An actual cost analysis is used to illustrate and integrate the various concepts and methods taught in the course.

Also, for the DoD training course "Quantitative Techniques for Cost and Price Analysis," the scope of the course was to provide contracting personnel the quantitative techniques to estimate and analyze individual elements of cost.

DoD 5000.52-M, "Career Development Program for Acquisition Personnel," November 1991, requires a combined cost/price analysis course for entry-level (General Schedule-5/7) contracting personnel. DoD also requires a cost/price analysis course for intermediate- and supervisory-level contracting personnel if their jobs are primarily oriented toward proposal analysis. A combined cost/price quantitative techniques course is required for intermediate-level (General Schedule-9/11/12) contracting and financial services personnel who perform cost/price analysis tasks. An advanced cost/price analysis course is required for senior- and supervisory-level (General Schedule-13/14/15) contracting and financial services personnel. Army, Navy, Air Force, and DLA price analysis requirements do not significantly differ from DoD requirements. Current training courses need to be restructured for basic-, intermediate-, senior-, and supervisory-level contracting personnel to emphasize the performance and documentation of price analysis techniques.

Only one location used a separate price analysis training course to train all contract negotiation personnel. The Defense Personnel Support Center contracted with a commercial vendor to conduct a 3-day course based on Armed Services Pricing Manual price analysis techniques. The Defense Personnel Support Center training coordinator stated that the goal was to have all contracting personnel attend, but that due to funding constraints only 40 percent of the contracting personnel were able to attend the course.

The other activities reviewed had limited price analysis training. The Air Force Audit Agency (Report No. 91064045, "Negotiation of Noncompetitive Acquisitions from $100,000 to $500,000," July 27, 1992) recommended that AFMC establish a price analysis course to train contracting personnel involved with procurements valued from $100,000 to $500,000. AFMC is scheduled to complete development of a training course in price analysis techniques for contracting personnel by December 31, 1993.

Recommendations, Management Comments, and Audit Response

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

a. Issue written internal control objectives and verification techniques that:

(1) Require contracting officers to perform and verify price analysis using such techniques as comparing proposed prices with historical contract prices, independent Government cost estimates, or other price analysis techniques detailed in the Armed Services Pricing Manual, as required by Federal Acquisition Regulation 15.805, "Proposal Analysis."

(2) Require contracting officers to document the price analysis results in the negotiation memorandum.

b. Issue guidance to implement the Director of Defense Procurement December 5, 1990, memorandum, "Increase in Cost or Pricing Data Threshold," and May 29, 1992, memorandum, "Certified Cost or Pricing Data," that describes those situations requiring certified cost or pricing data in evaluating proposals under $500,000.

Air Force and DLA Comments. The Air Force concurred and stated that AFMC developed a price negotiation memorandum checklist that specifically addresses whether or not a price analysis was performed and how the price was determined to be fair and reasonable. The Air Force also stated that the documentation of price analyses was included as an item of interest in Air Force procurement management and pricing effectiveness reviews. Further, to reduce confusion on use of the SF 1411, "Contract Pricing Proposal Cover Sheet," the Air Force is developing a FAR case to clarify use of the SF 1411 for submission of cost data that are not required to be certified. The FAR case would define how a contractor should submit uncertified cost data for the purpose of cost realism analysis. The Air Force stated the FAR case would be ready in September 1993.

DLA concurred and stated that specific internal control objectives and verification techniques would be incorporated into the pricing and negotiation chapters of the new DCMC manual and that interim guidance would be issued by December 31, 1993. DLA stated that when the Director of Defense Procurement issued guidance on the change in the cost or pricing threshold, it was sent to DLA field activities. DLA also stated it would issue the Director of Defense Procurement guidance, with added emphasis, to DLA field activities by September 30, 1993. DLA will also incorporate the Director of Defense Procurement guidance in the new DCMC manual.

Army Comments. The Army did not concur. The Army stated that the FAR and Army FAR supplement adequately describe when and how price and cost analyses are to be performed. The Army also stated that the report does not provide evidence that the Army failed to perform price analyses when required or that the Army inappropriately performed cost analyses. Further, the Army stated that where price analysis is mandatory, the analysis will be better documented and more extensive.

Audit Response. We agree with the Army position that the FAR and Army FAR supplement adequately describe when and how price and cost analyses are to be performed and, therefore, we revised the report to clarify our comments and to ensure consistency with the FAR and the Director of Defense Procurement guidance. The Army did a better job of performing and documenting price analysis than the other Military Departments and DLA. However, the Army did not perform price analyses for 3 of the 12 contract actions where it was mandatory. Also, the Army performed cost analyses that were not required or that were not adequately justified and approved on 9 of the 11 contract actions priced under $500,000 and did not require the contractor to certify the provided cost or pricing data on the 9 actions.

We believe that contractor and Government resources are not properly utilized when cost or pricing data are obtained for actions priced under $500,000 unless the contracting officer can justify and obtain approval that the cost or pricing data are necessary to evaluate the reasonableness of the contractor or subcontractor proposed price. Also, if cost or pricing data were required to evaluate the reasonableness of the proposed price, then the contracting officer should obtain contractor certification of the data. We request the Army to reconsider its position on the recommendations and provide additional comments on the report.

Navy Comments. The Navy partially concurred with Recommendation 1.a. and stated that a supplementary price analysis is discretionary in those instances where cost analysis is required to be performed. Additionally, the Navy Acquisition Procedures Supplement requires that "the business clearance memorandum shall fully explain the cost/price aspects of the proposed acquisition . . .." The Navy also stated that a price analysis methodology would be explained in the business clearance memorandum when price analysis was the primary analytical method.

The Navy concurred with Recommendation 1.b. The Navy stated the Director of Defense Procurement guidance memorandums were distributed to Navy

procurement commands for information and action December 10, 1990, and June 10, 1992. However, the Navy expressed concern with the emphasis of the report, stating that the report implies that only price analysis techniques should be employed to justify contract actions under the $500,000 threshold. The Navy also stated that the report conflicts with the statute and Director of Defense Procurement guidance and would be interpreted improperly with the result that insufficient justification of price reasonableness would result.

Audit Response. We agree with the Navy position that price analyses are discretionary when certified cost or pricing data are obtained. The FAR provides that when cost or pricing data are required, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements. The FAR also recommends, but does not mandate, the performance of price analysis even when certified cost or pricing data are required, to ensure that the overall price offered is fair and reasonable. We agree that the proposal analysis requirements in the Navy Acquisition Procedures Supplement may implicitly require the documentation of price analysis techniques where price analysis is the primary analysis technique. However, our primary concern was those actions for which the Navy performed cost analysis on uncertified cost or pricing data and then did not perform a price analysis. We believe that contracting officers should be required to document an explicit discussion of price analysis techniques, or alternatively, why price analysis alone was not sufficient to determine a fair and reasonable price.

We disagree that the report implies that only price analysis techniques should be used for contract actions under $500,000. Cost analysis is appropriate when justified and documented in accordance with the FAR and Director of Defense Procurement guidance. Our concerns were that the Navy and other Defense contracting activities were not adequately justifying and documenting the use of cost analysis for contracting actions under $500,000 (that is, routinely continuing to use cost analysis), were not always obtaining certified cost or pricing data when performing cost analysis, and were not performing price analyses when certified cost or pricing data were not obtained. We revised sections of the report to clarify statements concerning the FAR and Director of Defense Procurement guidance and audit results. The Navy did not comment on how the Navy plans to implement the recommendation. We request the Navy to reconsider its position and provide additional comments on the recommendation.

2. We recommend that the Assistant Secretary of the Navy (Research, Development, and Acquisition); the Assistant Secretary of the Air Force (Acquisition); and the Director of the Defense Logistics Agency establish a separate section in the negotiation memorandum for price analysis.

Air Force and DLA Comments. The Air Force concurred and stated that AFMC has developed a negotiation memorandum format for use when evaluating a contract action using price analysis. DLA concurred and stated it was developing a format, similar to that recommended in the report, with a separate section for price analysis. DLA also stated that guidance on the new price analysis section would be issued by September 30, 1993, and that the guidance would be included in the new DCMC manual.

Navy Comments. The Navy nonconcurred and stated that, where price analysis is the primary analytical method, it is implicit in the Navy Acquisition Procedures Supplement that the business clearance memorandum will substitute a full explanation of the price analysis methodology (in place of a cost analysis methodology) used to determine a fair and reasonable price. The Navy also stated that procurement management reviews at the major procurement activities would review the adequacy of price analysis coverage, where applicable.

Audit Response. We agree that the Navy Acquisition Procedures Supplement implies a requirement for documentation of price analyses for contract actions between $100,000 and $500,000 where no cost or pricing data were required. However, we believe that an explicit requirement for a price analysis discussion is also needed where contracting officers request cost or pricing data. While the Navy use of procurement management reviews may add to the understanding of price analysis techniques at Component commands, the reviews are not a substitute for the use and documentation of price analysis techniques for individual procurements. Accordingly, we request the Navy to provide additional comments on the recommendation.

3. We recommend that the Deputy Under Secretary of Defense (Acquisition Reform) restructure current training requirements in price analysis techniques for basic-, intermediate-, senior-, and supervisory-level contracting personnel to emphasize the performance and documentation of price analysis techniques.

Redirected Recommendation. We originally addressed Recommendation 3. to the Director, Acquisition Education, Training, and Career Development, Office of the Under Secretary of Defense for Acquisition. Based on comments from the Director, we redirected Recommendation 3. to the Deputy Under Secretary of Defense (Acquisition Reform).

Management Comments and Audit Response on the Finding

Navy Comments. The Navy stated that the audit results reflected procurement actions that occurred in the early transition period under the increased $500,000 threshold for certified cost or pricing data. The Navy also stated that pricing actions undertaken now would better indicate how contracting officers analyze and price procurement actions under $500,000. Furthermore, the Navy stated, this report should not be issued until after completion of a recently announced Inspector General, DoD, audit on the effect of the increased dollar-value threshold for certified cost or pricing data.

Audit Response. The sample of contractual actions was selected from FY 1992 contract actions that occurred 9 to 21 months after the increased threshold went into effect. The Navy sent guidance on the increased threshold to its procurement commands on December 10, 1990. Navy contracting officers had almost 2 years to read and implement the two-page memorandum on the revised pricing threshold. We believe the Navy should aggressively implement the report Recommendations 1. and 2. to improve the pricing of contract actions

and to reduce contractor and Government contracting costs instead of waiting for the passage of time to improve the process. Furthermore, delaying issuance of this audit report is not a good management practice. The information in the report would become dated for those contracting officers that can use it to improve their acquisition practices.

DLA Comments. DLA stated cost analysis was required on 14 of 20 contracts at DCMAO, EL Segundo, because the contractor had serious estimating system deficiencies.

Audit Response. Of the 20 contracts at DCMAO, El Segundo, three actions were valued over $500,000 and 17 actions were valued under $500,000. For the three actions over $500,000, the contracting officer properly obtained certified cost or pricing data. The contracting files for the 17 actions do not support the DLA contention that the contractors had serious estimating system deficiencies. Reviewed contract documentation (price negotiation memorandum, prenegotiation memorandum, and price/cost analysis report) indicated that the contractor estimating system was adequate or that the adequacy of the estimating system was not addressed. DCMAO, El Segundo, performed cost analyses that were not required or that were not adequately justified and approved on 17 contract actions valued under $500,000. Further, DCMAO, El Segundo, required the contractor to certify the cost or pricing data for only one contract action.

Part III - Additional Information

Appendix A. Director of Defense Procurement Memorandums on Price Analysis

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-4000

PRODUCTION AND
LOGISTICS

P/DARS

DEC 0 5 1990

In reply refer to
DAR Case: 90-303
D.L. 90-013

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DIRECTOR, CONTRACTING, ASA(RD&A)/SFRD-KP
DIRECTOR, PROCUREMENT POLICY, ASN(RD&A)/API&A
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
EXECUTIVE DIRECTOR, CONTRACTING, DLA-P
EXECUTIVE DIRECTOR, CONTRACTING MANAGEMENT, DLA-A

SUBJECT: Increase in Cost or Pricing Data Threshold

Section 803 of Public Law 101-510 amended Section 2306a(a)(1) of Title 10, United States Code, to increase the threshold for submission of cost or pricing data.

Pending revision of the Federal Acquisition Regulation (FAR), you are immediately authorized a deviation to apply a $500,000 threshold, vice $100,000, in regulatory guidance and clauses. We have attached a list of FAR cites impacted. The revised threshold applies to all contracts and subcontracts, and modifications or changes to such contracts and subcontracts, entered into subsequent to receipt of this deviation.

The statutory language provides that the threshold shall be returned to $100,000 for all contracts and subcontracts awarded after December 31, 1995, and for all contract changes or modifications made after December 31, 1995. Therefore, when you revise clauses to incorporate the higher threshold, the following shall be added as a new paragraph at the end of each clause: "The $500,000 threshold shall revert to $100,000 after December 31, 1995. Therefore, all subcontracts awarded after December 31, 1995, and/or all changes or modifications made after December 31, 1995, shall be subject to the $100,000 threshold."

Submission of cost or pricing data may be requested in situations where submission of such data is not otherwise required if the

Enclosure

contracting officer determines, in writing, that such data are necessary for the evaluation of the reasonableness of the price of the contract or subcontract.

Contracting officers should consider requiring cost or pricing data below the $500,000 threshold if the offeror, contractor, or subcontractor: (1) has recently used fraudulent cost estimating or fraudulent cost accounting practices in the performance of government contracts; (2) currently has significant deficiencies in such estimating systems; or (3) has been the subject of recent recurring and significant findings of defective pricing. However, such data should not be required if the price of a contract or subcontract is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

When certified cost or pricing data are not required, contracting officers may require the submission of partial or limited cost data if considered necessary to ensure price reasonableness. For, example, detailed cost data might be necessary to support an analysis of material costs, but not for labor and overhead costs. In the case of commercial items, contracting officers should require the submission of information on the prices at which the offeror has previously sold the same or similar products.

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary of
Defense (Procurement)

Attachment

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

ACQUISITION

MAY 29 1992

DP/CPF

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY ASSISTANT SECRETARY OF THE ARMY FOR PROCUREMENT, ASA(RD&A)
DEPUTY FOR ACQUISITION POLICY, INTEGRITY AND ACCOUNTABILITY, ASN(RD&A)/API&A
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE FOR CONTRACTING, SAF/AQC
EXECUTIVE DIRECTOR, CONTRACTING, DLA-P
EXECUTIVE DIRECTOR, CONTRACT MANAGEMENT, DLA-A

SUBJECT: Certified Cost or Pricing Data

Five years ago, I issued a memorandum discouraging contracting officers from obtaining cost or pricing data when there is a reasonable expectation that a solicitation will result in adequate price competition. The memorandum stated there should rarely be a need to obtain certified cost or pricing data when a contract will be awarded to the responsible offeror submitting the lowest evaluated price. Recent events indicate this subject requires additional clarification.

Contracting officers shall not require the submission or certification of cost or pricing data when contract price is based on adequate price competition, based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation. This policy applies to subcontracts as well as prime contracts, and contracting officers should not require a prime contractor to obtain cost or pricing data from a subcontractor that qualifies for an exemption. This policy may also apply to a portion of a contract or subcontract when, for example, a contractor will provide both an item that qualifies for a catalog exemption and a service that does not qualify for an exemption. If the portion of the contract that does not qualify for the exemption exceeds the threshold for submission of cost of pricing data (currently $500,000), cost or pricing data should be obtained for that portion of the contract only.

When cost or pricing data are not obtained, contracting officers must perform a price analysis to ensure price reasonableness. If adequate price competition exists, evaluation of the competitive proposals usually satisfies the requirement to perform a price analysis.

However, FAR 15.805-2 lists other price analysis techniques that may be used, and Volume 2 of the Armed Services Pricing Manual (ASPM) provides additional instructional material on price analysis techniques and sources of data that may be used to ensure price reasonableness.

Price analysis may also be performed to determine the price reasonableness of individual line items, and value analysis (as discussed in Chapter 14 of the ASPM) may be used to determine why similar items should be priced differently because of different technical features and performance parameters relevant to the requirements of the particular procurement. Data to perform a price analysis can be obtained from a variety of sources. For example, data may be available from recent competitive procurements, supplier catalogs, subcontractor quotes, and information provided by offerors. Market data may also be available for similar products.

If cost or pricing data are not obtained from the prime contractor, there is no statutory or regulatory requirement for prime contractors to obtain such data from subcontractors. Subcontractors must provide cost or pricing data only if the value of the subcontract exceeds the threshold for submission of cost or pricing data and the prime contractor and each higher-tier subcontractor have been required to provide cost or pricing data.

When data such as cost breakdowns are required to determine the cost realism of competing offers or to evaluate competing approaches for major acquisitions, they may be obtained. Cost breakdowns obtained for these purposes should not be considered to be cost or pricing data and should not be certified. Data requirements should always be tailored so that only necessary data are requested.

The use of price analysis techniques should ensure that the Department of Defense obtains the best value for its scarce procurement dollars and that cost or pricing data are not obtained when alternate methods of pricing contracts are more appropriate. However, if adequate price competition is expected on a procurement but does not materialize, cost or pricing data must be obtained. Also, please note that different requirements apply when contracting for commercial items in accordance with the procedures set forth in DFARS Subpart 211.70.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Appendix B. Summary of FY 1992 Contractual Actions Reviewed

FY 1992 Contract Actions Valued from $100,000 to $500,000

Location	Contract Actions Reviewed	Total Negotiated Value	Price Analysis Was Not Performed		Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum		Cost Analysis Was the Basis of the Negotiation Objective	DCAA Audit Was Obtained*	Detailed Cost or Pricing Data Were	
			Number	Value	Number	Value			Provided	Certified*
Army										
Aviation and Troop Command	6	$1,648,829	2	$ 433,760	0	$ 0	4	1	4	0
Missile Command	5	1,251,287	1	433,146	1	195,625	5	1	5	0
Total Army	11	$2,900,116	3	$ 866,906	1	$ 195,625	9	2	9	0
Navy										
Naval Sea Systems Command	3	$ 977,952	2	$ 595,723	1	$ 399,676	3	2	3	2
Aviation Supply Office	14	3,704,284	1	154,126	6	1,589,202	6	0	8	1
Supervisor of Shipbuilding, Conversion, and Repair, San Diego	16	2,996,064	2	478,276	7	1,434,001	14	0	16	6
Total Navy	33	$7,678,300	5	$1,228,125	14	$3,422,879	23	2	27	9
Air Force										
Aeronautical Systems Center	12	$2,926,075	8	$2,034,102	0	$ 0	8	1	12	7
Total Air Force	12	$2,926,075	8	$2,034,102	0	$ 0	8	1	12	7

*Normally, DCAA audits and certified cost or pricing data are not required for contractual actions valued under $500,000.

FY 1992 Contract Actions Valued from $100,000 to $500,000 (cont'd)

Location	Contract Actions Reviewed	Total Negotiated Value	Price Analysis Was Not Performed Number	Price Analysis Was Not Performed Value	Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum Number	Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum Value	Cost Analysis Was the Basis of the Negotiation Objective	DCAA Audit Was Obtained*	Detailed Cost or Pricing Data Were Provided	Detailed Cost or Pricing Data Were Certified*
Defense Logistics Agency										
Defense Contract Management Area Operations, Atlanta	7	$1,358,972	7	$1,358,972	0	$ 0	6	4	7	2
Defense Contract Management Area Operations, El Segundo	17	3,520,643	15	3,274,460	2	246,183	17	1	17	1
Defense Plant Representative Office, General Dynamics, Fort Worth	11	2,442,227	10	2,297,060	1	145,167	11	0	11	11
Defense Plant Representative Office, Hughes, Los Angeles	9	1,413,302	1	126,018	2	231,420	9	0	9	1
Defense Plant Representative Office, Northrop, Hawthorne	4	1,404,722	2	774,116	2	630,606	4	0	4	0
Defense Personnel Support Center	12	4,009,655	4	1,388,281	2	448,223	1	0	1	1
Total Defense Logistics Agency	60	$14,149,521	39	$9,218,907	9	$1,701,599	48	5	49	16
Total Contract Actions Valued from $100,000 to $500,000	116	$27,654,012	55	$13,348,040	24	$5,320,103	88	10	97	32
Percent of Contract Actions Reviewed	100	100	47	48	21	19	76	9	84	28

*Normally, DCAA audits and certified cost or pricing data are not required for contractual actions valued under $500,000.

Appendix B. Summary of FY 1992 Contractual Actions Reviewed

FY 1992 Contract Actions Valued Over $500,000

Location	Contract Actions Reviewed	Total Negotiated Value	Price Analysis Was Not Performed		Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum		Cost Analysis Was the Basis of the Negotiation Objective	DCAA Audit Was Obtained	Detailed Cost or Pricing Data Were	
			Number	Value	Number	Value			Provided	Certified
Army										
Aviation and Troop Command	4	$13,017,055	0	$ 0	0	$ 0	3	2	3	3
Missile Command	14	33,058,324	2	8,511,618	2	1,661,081	14	10	14	13
Total Army	18	$46,075,379	2	$8,511,618	2	$1,661,081	17	12	17	16
Navy										
Naval Sea Systems Command	3	$ 8,075,037	1	$ 595,723	1	$2,885,789	2	0	2	2
Aviation Supply Office	9	18,286,050	1	2,201,500	0	0	7	4	8	7
Supervisor of Shipbuilding, Conversion, and Repair, San Diego	4	6,865,721	1	3,235,625	3	3,630,096	4	3	4	4
Total Navy	16	$33,226,808	3	$6,032,848	4	$6,515,885	13	7	14	13
Air Force										
Aeronautical Systems Center	10	$699,175,627	9	$697,531,476	1	$1,644,151	6	4	10	7
Total Air Force	10	$699,175,627	9	$697,531,476	1	$1,644,151	6	4	10	7
Defense Logistics Agency										
Defense Contract Management Area Operations, Atlanta	5	$ 4,606,841	5	$ 4,606,841	0	$ 0	5	5	5	3

FY 1992 Contract Actions Valued Over $500,000 (cont'd)

Location	Contract Actions Reviewed	Total Negotiated Value	Price Analysis Was Not Performed		Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum		Cost Analysis Was the Basis of the Negotiation Objective	DCAA Audit Was Obtained	Detailed Cost or Pricing Data Were	
			Number	Value	Number	Value			Provided	Certified
Defense Logistics Agency (cont'd)										
Defense Contract Management Area Operations, El Segundo	3	$ 2,269,374	3	$ 2,269,374	0	$ 0	3	2	3	3
Defense Plant Representative Office General Dynamics, Fort Worth	4	6,654,656	4	6,654,656	0	0	4	2	4	4
Defense Plant Representative Office, Hughes, Los Angeles	5	10,654,587	2	4,092,680	0	0	5	5	5	5
Defense Personnel Support Center	13	32,140,232	2	5,689,046	2	3,797,106	3	3	3	2
Total Defense Logistics Agency	30	$56,325,690	16	$23,312,597	2	$3,797,106	20	17	20	17
Total Contract Actions Valued Over $500,000	74	$834,803,504	30	$735,388,539	9	$13,618,223	56	40	61	53
Percent of Contract Actions Reviewed	100	100	41	88	15	2	76	54	82	72
Summary Total Contractual Actions Reviewed	190	$862,457,516	85	$748,736,579	33	$18,938,326	144	50	158	85
Percent of Contract Actions Reviewed	100	100	45	87	17	2	76	26	83	45

Appendix B. Summary of FY 1992 Contractual Actions Reviewed

FY 1992 Contract Actions Summary Totals by Military Department and Defense Logistics Agency

Location	Contract Actions Reviewed	Total Negotiated Value	Price Analysis Was Not Performed		Price Analysis Was Performed But Not Adequately Documented in the Negotiation Memorandum		Cost Analysis Was the Basis of the Negotiation Objective	DCAA Audit Was Obtained*	Detailed Cost or Pricing Data Were	
			Number	Value	Number	Value			Provided	Certified*
Army	29	$ 48,975,495	5	$ 9,378,524	3	$ 1,856,706	26	14	26	16
Navy	49	40,905,108	8	7,260,973	18	9,938,764	36	9	41	22
Air Force	22	702,101,702	17	699,565,578	1	1,644,151	14	5	22	14
Defense Logistics Agency	90	70,475,211	55	32,531,504	11	5,498,705	68	22	69	33
Summary Total Contractual Actions Reviewed	190	$862,457,516	85	$748,736,579	33	$18,938,326	144	50	158	85

*Normally, DCAA audits and certified cost or pricing data are not required for contractual actions valued under $500,000.

Appendix C. Summary of Prior Audits and Other Reviews

General Accounting Office

NSIAD-87-28 (OSD Case No. 6851-6), "Procurement: Spare Parts Initiatives Air Force Implementation," February 13, 1987. The report stated that inadequate price analyses occurred in 34.6 percent of the sampled procurements with growth of 25 percent or more. Inadequate price analyses occurred frequently on first-time procurements (36.6 percent of the sample) and procurements with price decreases (30.6 percent of the sample). Adequate price analyses on first-time procurements are particularly important because the acceptability of future prices often depends on how they compare with first-time prices. As a result of the report, the Air Force issued a letter to all commands outlining price analyses pitfalls and citing the examples of the inadequate price analyses contained in the report. The letter requested appropriate officials to remind buyers of the pitfalls and to ask buyers to be aware of the pitfalls during the use of price analyses.

Inspector General, DoD

Report No. 93-105, "Procurement of Spare Parts and Supplies," June 4, 1993. The report stated that 32 of 141 spare parts were unreasonably priced. As a result, DoD buying centers overpaid $621,572 on 32 spare part items valued at $1.9 million. The unreasonably priced items were overpriced because buying centers did not perform adequate price analyses or Government price estimates were not prepared before contract award. The report recommended that guidance be issued to item managers and contracting officers to obtain independent Government estimates based on engineering analyses for use in evaluating proposed prices on certain items when needed and to have contractors identify manufacturers during the acquisition process. The report also recommended reporting the results of the Military Departments and DLA pricing review programs at inventory control points. The Military Departments and DLA generally concurred with the recommendations. The Deputy Under Secretary of Defense (Logistics) had not responded at the time of this report on the need for reporting on the pricing review programs.

Report No. 87-108, "Final Report on the Survey of Price Analyses of DoD Contractor Proposals," March 23, 1987. The report addressed whether pricing reviews to determine the reasonableness of contractor proposals were effectively conducted at procuring and contracting administration offices in accordance with the FAR. The report stated that 42 of 48 sampled contract actions contained

adequate documentation to support the conclusions that sufficient price analyses were performed to ensure price reasonableness. The other six contract actions had inadequate or no price analyses, but no significant indicators suggested that the Government paid unreasonable prices. Of the 42 contract actions, 7 were also supported by cost or technical analyses or both. The report had no recommendations.

Department of the Navy

Office of the Assistant Secretary of the Navy (Research, Development, and Acquisition), "Procurement Management Review of the Naval Sea Systems Command," August 14, 1992. The report concluded that price analysis is needed on cost-type service contracts and that the price analyses performed require more than a comparison of prior years' prices for similar items with a brief discussion of discrepancies. The report indicated that price analysis for cost-type service contracts would generally not require more than a comparison of incurred rates, particularly loaded composite rates, with the proposed rate and a discussion of differences. However, Naval Sea Systems Command dual-source procurements generally contained an adequate price analysis. Naval Sea Systems Command business clearances typically omit this useful analysis or contain a clearly inadequate analysis. The Navy Procurement Management Review staff recommended that the Naval Sea Systems Command increase utilization of price analysis in business clearances.

Naval Audit Service

Report No. 045-S-90, "Public Works Procurement and Contracting At The U.S. Naval Academy," April 30, 1990. The report stated that the Naval Academy Resident Officer in Charge of Construction and responsible Naval Academy departmental personnel did not review or challenge large variances between Government estimates and contractor offers before contract award. The Navy awarded contracts without performing sufficient price analyses even when the contractor proposals exceeded Government cost estimates by as much as $342,000, or 55 percent. As a result, the Navy had less assurance that it obtained the best product or service for the best price. The report recommended that the Superintendent, Naval Academy develop and implement procedures to perform detailed price analyses when large variances between Government cost estimates and contractor offers occur and include price analyses data in official contract files. The Superintendent concurred. As of September 1, 1989, the Engineering Division, Public Works Department, Naval Academy, analyzes the unit prices used and quantities stipulated for which the contractor's bid offer varies by more than 15 percent from the Government estimate. The Engineering Division will also provide a more detailed breakdown of line items of work required as practical, develop justification as to why large variances

occurred, and provide this information to the Naval Academy Resident Officer in Charge of Construction for inclusion in the official contract file.

Air Force Audit Agency

Report No. 91064045, "Negotiation of Noncompetitive Acquisitions from $100,000 to $500,000," July 27, 1992. The report stated that AFMC air logistics center contracting personnel did not accomplish adequate price analyses for 35 of the 67 contracts reviewed. As a result, the air logistics centers awarded $8.4 million in noncompetitive contracts without assurance that the price was fair and reasonable. This problem occurred partially because air logistics center contracting personnel lacked adequate knowledge and training in price analysis requirements of the FAR, the Armed Services Pricing Manual, and the Air Force Regulation 70-18, "Contracting Pricing." Also, contracting personnel did not review historical pricing information included in the contract files from previous purchases, and management had not established internal controls, such as a contract file documentation checklist to verify completion of price analysis, or implemented a pre- or post-award review to ensure contracting personnel had completed the analysis. The report recommended that AFMC direct air logistics center directorates of contracting to fully train air logistics center contracting officials on the requirements of the FAR, the Armed Services Pricing Manual, and the Air Force Regulation 70-18 concerning price analysis and establish internal control procedures to ensure that contracting personnel complete price analyses. AFMC concurred with both recommendations and took the initiative to inventory and assess the adequacy and currency of existing training for pricing personnel within the command. To comply with the first recommendation, AFMC revamped the "Principles of Contract Pricing," training course with a renewed focus on price analysis techniques. Also, the new AFMC FAR Supplement 5315.808-91, "Post-Award Price Negotiation Memorandum Review," July 1, 1992, established requirements for price negotiation memorandum review, uniform pricing memorandum formats, and checklists developed for distribution to all field activities.

Appendix D. Air Force Example of Price Analysis Documentation

PRICE NEGOTIATION MEMORANDUM
(Price Analysis Only)

A. CONTRACTOR NAME AND ADDRESS

B. CONTRACT/ORDER NUMBER

C. PURCHASE REQUEST NUMBER

D. DESCRIPTION OF ITEMS OR SERVICES (Include appl end item, function, acq situation, etc.)

E. PRICE SUMMARY - UNIT PRICES

CLIN	NOUN or NSN	PART NUMBER	QTY	PROPOSED	OBJECTIVE	NEGOTIATED
TOTAL CONTRACT PRICE SUMMARY:				PROPOSED	OBJECTIVE	NEGOTIATED

F. PRICE ANALYSIS (Complete blocks as appropriate)
If other than the historical comparison technique is used, prior purchases for each item shall be identified and addressed in accordance with AFFARS 5315.808.

1. [ ] ESTABLISHED CATALOG/MARKET PRICE. Commercial items sold in substantial quantities to the general public.
CLINs_____

A. [ ] Item is commercial item or,
[ ] Item is similar to commercial item (explain comparability in Section J)

B. [ ] Copy of published Catalog page attached or,
Publication:_____ Pg No:_____ Date:_____
[ ] Price quoted is a market price

C. [ ] Verified that item is sold in substantial quantities to general public.
Percent sales to comm'l customers (other than Gov't contractor): %_____ or,

	NAME	QTY	UNIT PRICE
Recent Comm'l Sale-(C)			
Recent Comm'l Sale-(NC)			

[ ] Verified by other means (explain in Section J)

D. [ ] Verified discount applicable/not applicable. Percent discount: %_____

2. [ ] HISTORICAL COMPARISON (If comparing to similar item explain comparability in Section J)
CLINs_____

PREVIOUS BUY						CURRENT BUY		
Prior Contract No.	Award Date	Qty	Prior * Determination	Unit Price	Adj Unit Price **	CLIN	Qty	Unit Price

* Document the basis under which the prior price was determined fair and reasonable. Hist. bases considered valid for comparison are identified in AFMCFARS 5315.805-2(b).
** Adjustments made to the prior price shall be explained in Section J.

[ ] Prior contract file reviewed: Clins: _____

[ ] Significant differences have been addressed for each line item in Sec J or attached

[ ] 25% certification required? (DFARS 217.7504-Consider "all" buys within 12 mths notwithstanding the requirements of AFMCFARS 5315.805-2)

3. [ ] GOVERNMENT ESTIMATE
CLINs_____

The Government Estimate is an:
[ ] Independent Govt Cost Estimate (Elemental breakout attached) or,
[ ] Govt Price Estimate (Bottom line est. based on review of drawings/specs/TOs)

Estimate provided by: _____ Dt. of Est.
Name/Title/Organization/Phone

* Adjustments made to estimate (qty,escal,etc.) should be supported in Section J.

4. [ ] FORMULA PRICING AGREEMENT established by: _____
(Govt Agency)
CLINs_____

[ ] Current status verified

5. [ ] OTHER (Explain Section J)
CLINs_____

(example: CERs, GSA/FSS, Price set by law)

G. NEGOTIATION ATTENDEES AND PERSONNEL CONTACTED:

	Name	Position/Organization	Phone	Date
Contractor				
Government				

* Negotiation Participants

H. DELIVERY SCHEDULE [ ] does [ ] does not meet need date. (explain in Section J)

I. CONTRACT TYPE [ ] Firm Fixed Price [ ] Other (explain in Section J)

J. ADDITIONAL COMMENTS/EXPLANATIONS:

K. LIST OF ATTACHMENTS

BASED ON THE INFORMATION CONTAINED HEREIN, THE PRICE IS DETERMINED FAIR AND REASONABLE

Contract Negotiator	Contracting Officer

Appendix E. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.a.	Internal Control. Written internal control objectives and techniques will improve contracting officers use of price analyses.	Undeterminable.*
1.b.	Compliance. Procedures will limit the amount of detailed cost analyses required in evaluating proposals under $500,000.	Undeterminable.*
2.	Compliance. Procedures will improve use and documentation of price analyses.	Undeterminable.*
3.	Compliance. Revised training course requirements will improve performance and documentation of price analyses.	Undeterminable.*

*The improved use of price analysis techniques and reduced requests for detailed cost data will result in decreased acquisition costs. However, we cannot quantify the amount of benefits because of the number of variables involved in thousands of pricing actions that occur annually.

Appendix F. Activities Visited or Contacted

Office of the Secretary of Defense

Director of Defense Procurement, Washington, DC
Deputy Under Secretary of Defense (Acquisition Reform), Washington, DC
Deputy Under Secretary of Defense (Logistics), Washington, DC

Department of the Army

Assistant Secretary of the Army (Financial Management), Washington, DC
Assistant Secretary of the Army (Research, Development, and Acquisition), Washington, DC
Army Materiel Command, Alexandria, VA
  Army Aviation and Troop Command, St. Louis, MO
  Army Missile Command, Redstone Arsenal, AL

Department of the Navy

Assistant Secretary of the Navy (Financial Management), Washington, DC
Assistant Secretary of the Navy (Research, Development, and Acquisition), Washington, DC
Naval Sea Systems Command, Arlington, VA
  Supervisor of Shipbuilding, Conversion, and Repair, Navy, San Diego, CA
Navy Aviation Supply Office, Naval Supply Systems Command, Philadelphia, PA

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Air Force Materiel Command, Wright-Patterson Air Force Base, OH
  Aeronautical Systems Center, Wright-Patterson Air Force Base, OH
Auditor General, Air Force Audit Agency, Wright-Patterson Air Force Base, OH

Defense Agencies

Defense Contract Audit Agency, Alexandria, VA
Defense Logistics Agency, Alexandria, VA
  Defense Personnel Support Center, Philadelphia, PA

Appendix F. Activities Visited or Contacted

Defense Contract Management Command, Alexandria, VA
- Defense Contract Management District South, Atlanta, GA
  - Defense Contract Management Area Operations, Atlanta, GA
  - Defense Plant Representative Office, General Dynamics, Fort Worth, TX
- Defense Contract Management District West, El Segundo, CA
  - Defense Contract Management Area Operations, El Segundo, CA
  - Defense Plant Representative Office, Hughes, Los Angeles, El Segundo, CA
  - Defense Plant Representative Office, Northrop, Hawthorne, CA

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition
Director of Defense Procurement
Deputy Under Secretary of Defense (Acquisition Reform)
Deputy Under Secretary of Defense (Logistics)

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Assistant Secretary of the Army (Research, Development, and Acquisition)
Auditor General, Army Audit Agency

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Research, Development, and Acquisition)
Auditor General, Naval Audit Service

Department of the Air Force

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

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency

Non-Defense Activities and Individuals

Office of Management and Budget

Appendix G. Report Distribution

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

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Office of the Under Secretary of Defense for Acquisition Comments

Final Report Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

ACQUISITION

28 JUL 1993

MEMORANDUM FOR INSPECTOR GENERAL, DOD
THROUGH: CONGRESSIONAL ACTIONS & INTERNAL REPORTS (AP&PI) 26 July 93

SUBJECT: Comments on Draft Audit Report on Contracting Officer Price Analyses (Project No. 2CA-0071)

Recommendation for Corrective Action Number 3 calls for the Director of Acquisition Education, Training and Career Development to restructure training requirements. While the intent of this recommendation is supported, the Defense Contracting Career Management Board under DoD Instruction 5000.58 and the Defense Acquisition University under DoD Directive 5000.57 have authority and responsibility for training requirements and curriculum content. Because three elements reporting to the USD(A) have related responsibilities in responding to Recommendation 3, rephrase it as follows: "We recommend that the Under Secretary of Defense (Acquisition) restructure current requirements ..."

Redirected

Appendix F. Activities Visited or Contacted, erroneously cites contact with the Director of Acquisition Education, Training and Career Development in the second citation under "Office of the Secretary of Defense." In the interest of accuracy, delete this citation.

Deleted

James S. McMichael
Director, Acquisition Education,
Training & Career Development

Department of the Army Comments

Final Report Reference

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S. ARMY CONTRACTING SUPPORT AGENCY
5109 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041 3201

24 AUG 1993

REPLY TO ATTENTION OF

SFRD-KP

MEMORANDUM FOR INSPECTOR GENERAL, DOD (AUDITING)
400 ARMY NAVY DRIVE, ARLINGTON,
VIRGINIA 222041-2884

SUBJECT: Draft Audit Report on Contracting Officer Price Analysis (Project 2CA-0071)

This is in response to subject draft audit report dated June 16, 1993. The Army does not concur with recommendation 1 and the findings related thereto.

Subject audit focused on the adequacy of price analyses being performed by the Services and Defense Agencies. This was driven by the change in the threshold for requiring certified cost or pricing data and the subsequent increase in the number of proposals requiring only price analysis.

The auditors found a lack of price analysis, or an inadequately documented price analysis, in those instances where cost analysis was required. However, the FAR and DFARS do not mandate performance of price analysis where cost analysis is required; it is only encouraged. In those instances where price analysis is mandatory, the analysis will be better documented, and more extensive, as the analysis results will stand on their own to support the procurement.

Revised

The FAR and the Army FAR Supplement adequately describe when and how price and/or cost analyses are to be performed. The draft audit report fails to provide evidence that the Army has failed to perform price analyses when required, or has inappropriately performed cost analyses.

The point of contact for this action is Mr. Bruce Sullivan, who may be reached at (703) 756-2086.

J. Bruce King
Acting Director

Department of the Navy Comments

Final Report Reference

DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(Research, Development and Acquisition)
WASHINGTON D C 20350-1000

11 SEP 1993

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DRAFT AUDIT REPORT ON CONTRACTING OFFICER PRICE ANALYSES (PROJECT NO. 2CA-0071) - ACTION MEMORANDUM

Ref: (a) DODIG Memo of 16 June 1993

Encl: (1) DON Response to Draft Audit Report

I am responding to the draft audit report forwarded by reference (a) concerning contracting officer price analyses. Your report was reviewed in detail by members of my Acquisition Policy, Integrity and Accountability (APIA) staff who also met with representatives of your office to discuss our principal concerns. These concerns are addressed below.

Revised

Our first principal concern is that a reading of your report implies that only price analysis techniques should be employed in justifying contract price reasonableness for actions under $500,000.00. This view is not consistent with implementation guidance issued by the Director, Defense Procurement.

Our second principal concern is that the data used as the source for your report reflect procurement actions which came about in the early transition to operating under the revised $500,000 threshold for certified cost or pricing data. With the passage of time, it is our view that pricing transactions now being undertaken would be a much better indicator of how the under $500,000 procurement actions are being handled. Your representatives indicated during our discussions that another audit concerning actions taken under the revised $500,000 threshold is expected to start shortly. We believe it may be appropriate to withhold issuance of the subject report and incorporate its findings into the results of the planned follow-on audit.

Enclosure (1) provides additional comments on the subject draft report.

Edward C. Whitman

Edward C. Whitman

Final Report Reference

DEPARTMENT OF THE NAVY RESPONSE

TO

DODIG DRAFT REPORT OF JUNE 16, 1993

ON

CONTRACTING OFFICER PRICE ANALYSIS
PROJECT NO. 2CA-0071

Finding A:

Contracting Officers did not properly perform or adequately document the use of price analyses to determine whether contractor proposal prices were fair and reasonable. Also, price analyses were not adequately documented in the Government negotiation memorandums where contracting officers performed price analyses.

These conditions occurred because:

o DoD contracting officers relied on cost analyses in evaluating proposals when use of cost analysis was not required. Revised

o Internal controls covering the performance and documentation of price analysis techniques were ineffective at several of the activities reviewed.

o DoD contracting officers did not fully comply with regulations covering the proposal evaluation process and did not use or were unaware of various price analysis methods.

o Training for the performance and documentation of price analysis techniques was not adequate for contracting personnel.

Recommendation 1.a.:

We recommend that the Assistant Secretary of the Navy (Research, Development and Acquisition):

a. Issue written internal control objectives and verification techniques that:

(1) Require contracting officers to perform and verify price analysis using such techniques as comparing proposed prices with historical contract prices, independent Government cost estimates, or other price analysis techniques detailed in the Armed Services Pricing Manual, as required by Federal Acquisition Regulation section 15.805, "Proposal Analysis."

(2) Require contracting officers to document the price analysis results in the negotiation memorandum.

DON Position:

Partially concur. FAR 15.805-1(b) states "When cost or pricing data are required, the contracting officer shall make a cost analysis to evaluate the reasonableness of individual cost elements. In addition, the contracting officer should make a price analysis to ensure that the overall price offered is fair and reasonable. When cost or pricing data are not required, the contracting officer shall make a price analysis to ensure that the overall price offered is fair and reasonable." The DoDIG report cites as a violation of regulation those instances where cost analysis was performed without a supplementary price analysis also being performed. It is the DON position that in those instances where cost analysis is required to be performed that a supplementary price analysis is discretionary and should be performed only when, in the judgement of the contracting officer, such a supplementary analysis is necessary and appropriate.

With respect to documenting the price analysis results the Navy Acquisition Procedures Supplement (NAPS) at NAPS 5201.690-9(c) states "The business clearance memorandum shall fully explain the cost/price aspects of the proposed acquisition including the technical and cost/price evaluation where the source selection process is used; and properly address the findings and recommendations of the audit report." In those cases where price analysis is the primary analytical method it is implicit that the clearance will substitute a full explanation of the price analysis methodology used in determining a fair and reasonable price.

Recommendation 1.b.:

Implement Director of Defense Procurement guidance "Increase in Cost or Pricing Data Threshold," December 5, 1990, and "Certified Cost or Pricing Data," May 29, 1992, that describe those situations requiring cost or pricing data in evaluating proposals under $500,000.

DON Position:

Concur. The Director of Defense Procurement (DDP) guidance has been distributed. The DDP memorandum of December 5, 1990, was forwarded to the Navy buying commands for information and action on December 10, 1990. The DDP clarifying memorandum of May 29, 1992, was forwarded to the Navy buying commands on June 10, 1992.

We are concerned with the emphasis of the report. The report implies that only price analysis techniques should be employed to justify contract actions under the $500,000 threshold. The DDP memorandum of 5 December 1990, which provided formal notice of the threshold increase to $500,000, clearly puts forth the emphasis on employing streamlined pricing techniques for actions under $500,000. However, this same memorandum clearly states

that cost or pricing data may be requested, if justified and necessary for the evaluation of price reasonableness. The memorandum also states that partial or limited cost data may be required, if necessary to ensure price reasonableness. In our view, your report presents a view that conflicts with the statute and DDP guidance. Our view is that the report, as structured, will likely be interpreted improperly with the result that insufficient justification of price reasonableness will result.

Recommendation 2:

We recommend that the Assistant Secretary of the Navy (Research, Development, and Acquisition) establish a separate section in the negotiation memorandum for price analysis.

DON Position:

Non-concur. As noted in our response to Recommendation 1.a.(2), the NAPS includes a separate section for price analyses relative to follow-on buys. Additionally, the Procurement Management Reviews (PMR) conducted at the major buying activities by ASN(RDA) will include review of the adequacy of the coverage of price analysis where applicable.

GENERAL COMMENT:

In discussions with DoDIG representatives concerning this report, our office was advised that an additional audit is expected to be started with the next few months to further supplement this report. Our view is that the subject report is predicated on actions which took place in the early stages of the change in threshold from $100,000 to $500,000. As a result, the findings may not reflect the existing procedures which have evolved based on actual implementation and practice. It is recommended that issuance of the subject report be deferred and incorporated into the upcoming review. Such and approach will provide a broad focus which reflects the most current practices.

Department of the Air Force Comments

Final Report
Reference

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

18 AUG 1993

OFFICE OF THE ASSISTANT SECRETARY

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Contracting Officer Price Analyses Dated 16 June 1993, Project No. 2CA-0071 - INFORMATION MEMORANDUM

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) provide Air Force comments on the subject report.

Finding: Contracting officers did not properly perform or adequately document the use of price analyses to determine whether contractor proposal prices were fair and reasonable.

Answer: Concur.

a. Contracting officers do not routinely perform price analyses for all contracting actions. Although the FAR does not mandate that a price analysis be performed for all actions, it is recommended and we agree that, lacking good reason not to, one should be performed. In recognition that additional education was required, the Air Force restructured its basic pricing course (QMT 170) to significantly expand its coverage of price analysis. As more contracting personnel attend this course, we would expect an improvement in the quality of price analyses. Actions to correct the documentation problem are addressed in the responses to the audit's recommendations.

Revised

Page 7

b. It should be noted that there are several statements in the draft report that need to be clarified. The third sentence of the Introduction paragraph of the Executive Summary states, "...a price analysis forms the sole basis for the contract award." Although a price analysis may be the sole basis for evaluation of a price to be fair and reasonable, it is not the only consideration or basis for the award. The second paragraph on page 9 discusses the change in threshold from $100,000 to $500,000 and goes on to state, "Therefore, those proposals will only be evaluated by price analyses...." Although these proposals will **normally** be evaluated by price analysis, there will be occasions where cost and pricing data may be required. The contracting officer is the individual responsible for assuring that the Government receives sufficient information and performs the proper evaluations to ensure a fair and reasonable price. In some cases, this will require cost analysis.

Recommendation 1: SAF/AQ should:

a. Issue written internal control objectives and verification techniques that:

(1) Require contracting officers to perform and verify price analysis...."

(2) Require contracting officers to document the price analysis results in the negotiation memorandum.

b. Implement Director of Defense Procurement guidance "Increase in Cost or Pricing Data Threshold," December 5, 1990, and "Certified Cost or Pricing Data," May 29, 1992, that describe those situations requiring cost or pricing data in evaluating proposals under $500,000.

Answer: Concur.

a. The Air Force has already taken steps to implement these recommendations. As noted in the audit report, AFMC has developed a negotiation memorandum format for use when evaluating a contract action using price analysis. In addition, AFMC has also developed a price negotiation memorandum checklist which specifically addresses whether or not a price analysis was performed and how the price was determined to be fair and reasonable. The Air Force has also included the documentation of price analyses as an item of interest in SAF/AQC Procurement Management Reviews and HQ AFMC/IG Pricing Effectiveness Reviews. Based on the results from these reviews, we will consider expanding the use of the AFMC developed tools throughout the Air Force.

b. We agree that there is still confusion in the field regarding the use of cost and pricing data for proposals between $100,000 and $500,000. We believe that most of this confusion is related to the use of the SF 1411 for submission of cost data that need not be certified. We intend to develop a FAR case which will clarify use of the SF 1411 and define how a contractor should submit cost data for the purpose of cost realism analysis that need not be certified. This case should be ready by the end of September 1993.

IRA L. KEMP
Associate Deputy Assistant
Secretary (Contracting)
Assistant Secretary (Acquisition)

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

4 AUG 1993

IN REPLY REFER TO FOI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: OIG Draft Audit Report on Contracting Officer Price Analyses, Project No. 2CA-0071

This is in response to your 16 Jun 93 request.

4 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Division
Office of the Comptroller

cc:
AQCOD

Final Report Reference

FORMAT 1 of 4 DATE OF POSITION: 3 AUG 93

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Contracting Officer Price Analyses (Project No. 2CA-0071)

FINDING A: Contracting officers did not properly perform or adequately document the use of price analyses to determine whether contractor proposal prices were fair and reasonable. Our review of 190 FY 92 negotiated contractual actions ($862.5 million) showed that 85 (45 percent) contractual actions ($748.7 million) contained no evidence that a price analysis was performed. Also, price analyses were not adequately documented in the Government negotiation memorandums for 35 (33 percent) of 105 contractual actions valued at $21.6 million, where contracting officers performed price analyses. In 23 of the 190 contractual actions, price negotiation memorandums were missing from the contract records reviewed. Revised

These conditions occurred because:

o DoD contracting officers relied on cost analyses in evaluating proposals in 76 percent of 116 contract actions under $500,000 when use of cost analysis was not required. Revised

o internal controls covering the performance and documentation of price analysis techniques were ineffective at 7 of the 12 activities reviewed.

o DoD contracting officers did not fully comply with regulations covering the proposal evaluation process and did not use or were unaware of various price analysis methods.

o training for the performance and documentation of price analysis techniques was not adequate for contracting personnel.

As a result, assurances that fair and reasonable prices were obtained in all instances for negotiated contractual actions were inadequate.

DLA COMMENTS: Concur. The Defense Contract Management Command (DCMC) requires that price analysis be performed when required by the acquisition regulations and its use documented. In fact, policy revisions to be incorporated into the new DCMC manual require that price analysis be performed even in situations where its use under the regulations is discretionary. However, in many instances, cost analysis is required on actions under the $500,000 threshold; such as when the contracting officer deems it necessary, due to lack of pricing history for the contractor or when significant estimating system deficiencies exist with the contractor. This was the situation at DCMAO, El Segundo, where 14 of the 20 items reviewed were for one contractor who had serious estimating system deficiencies. FAR 15.805-1(b) states that when cost or pricing data are required, a cost analysis must be performed and that a price analysis should also be made. The above comment notwithstanding, we agree that our efforts should be improved in this area and will take actions in response

to each of your recommendations towards achieving greater use, better understanding, and improved documentation of price analysis.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(XX) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: David Ricci, AQCOD, (703) 274-4130
PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Defense Contract Management Command, Asst Exec Dir, Oper/Pol Group,

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

FORMAT 2 of 4

TYPE OF REPORT: AUDIT DATE OF POSITION: 3 AUG 93

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO. Contracting Officer Price Analyses
(Project No. 2CA-0071)

RECOMMENDATION 1A: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition), the Assistant Secretary of the Navy (Research, Development, and Acquisition), the Assistant Secretary of the Air Force (Acquisition), and the Director of the Defense Logistics Agency issue written internal control objectives and verification techniques that:

(1) Require contracting officers to perform and verify price analysis using such techniques as comparing proposed prices with historical contract prices, independent Government cost estimates, or other price analysis techniques detailed in the Armed Services Pricing Manual, as required by Federal Acquisition Regulation section 15.805, "Proposal Analysis."

(2) Require contracting officers to document the price analysis results in the negotiation memorandum.

DLA COMMENTS: Concur. DCMC requires price analysis techniques to be used as required by DoD regulations and appropriately documented. However, since price analysis is not being consistently performed or documented, we will incorporate specific internal control objectives and verification techniques into the pricing and negotiation chapters of the new DCMC manual. Interim guidance will be issued (by 31 Dec 93) prior to final publication of the manual.

DISPOSITION:
(XX) Action is ongoing. Estimated Completion Date: 31 Oct 94
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: (WHERE APPLICABLE)
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(X) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: David Ricci, AQCOD, (703) 274-4130
PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Defense Contract Management Command, Asst Exec Dir, Oper/Policy Group

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

FORMAT 3 of 4

TYPE OF REPORT: AUDIT DATE OF POSITION: 3 AUG 93

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO. Contracting Officer Price Analyses
(Project No. 2CA-0071)

RECOMMENDATION 1B: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition), the Assistant Secretary of the Navy (Research, Development, and Acquisition), the Assistant Secretary of the Air Force (Acquisition), and the Director of the Defense Logistics Agency implement Director of Defense Procurement guidance "Increase in Cost or Pricing Data Threshold," December 5, 1990, and "Certified Cost or Pricing Data," May 29, 1992, that describe those situations requiring cost or pricing data in evaluating proposals under $500,000.

DLA COMMENTS: Concur. The cited Director of Defense Procurement guidance was provided to our field activities at the time of issuance. However, we will reissue the letters (by 30 Sep 93), with added emphasis, to reinforce the guidance. This information will also be reflected in the new DCMC manual.

DISPOSITION:
(XX) Action is ongoing. Estimated Completion Date: 31 Oct 94
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: (WHERE APPLICABLE)
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(X) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: David Ricci, AQCOD, (703) 274-4130
PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Defense Contract Management Command, Asst Exec Dir, Oper/Policy Group

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

FORMAT 4 of 4

TYPE OF REPORT: AUDIT DATE OF POSITION: 3 AUG 93

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO. Contracting Officer Price Analyses
(Project No. 2CA-0071)

RECOMMENDATION 2: We recommend that the Assistant Secretary of the Navy (Research, Development, and Acquisition), the Assistant Secretary of the Air Force (Acquisition), and the Director of the Defense Logistics Agency establish a separate section in the negotiation memorandum for price analysis.

DLA COMMENTS: Concur. Current DCMC guidance (DLAM 8105.1, Part 15.808-3) requires discussion of the proposal evaluation performed. Further, Part 15.808-4 suggests use of the format for price negotiation memorandums (PNMs) contained in the Armed Services Pricing Manual. However, we will devise a format, similar to that recommended in the subject report, with a separate section for price analysis. The format will be included within the new DCMC manual. Direction mandating inclusion of a price analysis section in PNMs will be issued (by 30 Sep 93) prior to publication of the manual.

DISPOSITION:
(XX) Action is ongoing. Estimated Completion Date: 31 Oct 94
( ) Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: (WHERE APPLICABLE)
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

INTERNAL MANAGEMENT CONTROL WEAKNESS:
( ) Nonconcur.
(X) Concur; however, weakness is not considered material.
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: David Ricci, AQCOD, (703) 274-4130
PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Defense Contract Management Command, Asst Exec Dir, Oper/Policy Group

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