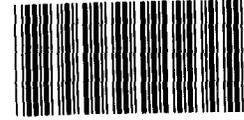


National Security and
International Affairs Division

B-242859



147491

September 3, 1992

Mr. William H. Reed
Director, Defense Contract Audit Agency

Dear Mr. Reed:

In May 1992 we reported to Senator John Glenn, Chairman, Senate Committee on Governmental Affairs, that the Defense Contract Audit Agency (DCAA) was unaware of 186, or 88 percent, of the subcontracts in our sample of 211 negotiated subcontracts that were contained in four major DOD prime contracts. Our report¹ discussed the reasons why the DCAA inventory of subcontracts subject to the Truth in Negotiations Act was incomplete.

In addition to those issues, we also came across several deficiencies that pertain to the 25 subcontracts from our sample that were included in the inventory, which DCAA was aware of. The purpose of this letter is to inform you of these deficiencies.

We found that DCAA field offices are not fully complying with DCAA guidance when developing their defective pricing inventories. DCAA field offices are

- not including subcontracts in their inventories in a timely manner;
- not retaining all subcontracts in their inventories for a full 3 years; and
- in one field office, combining subcontracts and subcontract modifications rather than listing each separately.

¹Contract Pricing: DCAA's Audit Coverage Lowered by Lack of Subcontract Information (GAO/NSIAD-92-173, May 29, 1992).

FIELD OFFICES ARE NOT INCLUDING SUBCONTRACTS
IN THEIR INVENTORIES IN A TIMELY MANNER

DCAA's guidance requires field offices to annually develop inventories of all contracts and subcontracts subject to defective pricing audits. For 1985 through 1989, DCAA required the field offices to prepare their inventories by December 31, but DCAA did not specify an award cut-off date for the contracts and subcontracts to be included in the inventory. For fiscal year 1990, DCAA changed its guidance and required that the inventories be prepared by March 31, 1989. For fiscal year 1991, DCAA required that inventories include contracts and subcontracts awarded by March 31, 1990.

We found that of 25 subcontracts that should have been included in 1987 through 1991 inventories, 15 were not included in inventories in a timely manner--9 of the 15 subcontracts were included 2 years later than required. Subcontracts that were not included in inventories in a timely manner totaled \$71 million, almost half of the value--\$147 million--of the 25 subcontracts. When contracts or subcontracts are not included in the inventories in a timely manner, we believe DCAA's audits of those contracts and subcontracts could be delayed which, in turn, could delay the collection of funds determined to be due to the government.

FIELD OFFICES DID NOT RETAIN ALL
SUBCONTRACTS IN INVENTORIES FOR 3 YEARS

DCAA requires that contracts and subcontracts be retained in defective pricing inventories for 3 years after the year of award. The Federal Acquisition Regulations state that contracts and subcontracts are subject to defective pricing audits until the records retention period expires, usually 3 years after final payment. To simplify its requirements planning, DCAA limits contract and subcontract retention to 3 full program years after the year the contract or subcontract was awarded. According to a DCAA defective pricing program official, retaining contracts and subcontracts for 3 years provides sufficient opportunity to select them for audit.

We examined the 25 subcontracts to determine whether DCAA retained them in its inventory for 3 years. Because of the parameters of our initial data request, we could not determine whether 9 of the 25 subcontracts were properly retained in DCAA's inventory. Of the remaining 16 subcontracts, 3 or 19 percent, were neither audited nor retained in field office

inventories for 3 years. These three subcontracts totaled \$3.8 million.

ONE FIELD OFFICE DID NOT SEPARATELY IDENTIFY SUBCONTRACT MODIFICATIONS

DCAA guidance states that a complete defective pricing inventory consists of all pricing actions subject to audit, including negotiated prime contracts, subcontracts, and modifications.

Of the 15 field offices responsible for the 25 subcontracts, 4 were resident offices. We found that one resident office's inventory (the Hamilton Standard Division Resident Office) listed subcontracts combined with their modifications--the modifications were not identified separately. For example, in fiscal year 1990, the field office inventory included 1 of the 25 subcontracts and showed that it totaled over \$39 million. However, the actual subcontract amount was about \$24 million, and the subcontract was subsequently changed by several modifications. We believe that when modifications are combined with subcontracts, the inventory understates the number of contract actions subject to audit that could cause the field audit office to understate its audit resource requirements. According to field office officials, the contractor's list--their primary source of data on all contracts--only provides the total value for a modified subcontract and does not provide the separate value of each modification.

We are concerned this practice may be occurring at other resident offices that also rely primarily on the contractor's list as their primary source of contract data. Therefore, we are reporting this one case to you so that you may pursue the issue further.

CONCLUSION

We believe that if subcontracts are not included in DCAA's inventory within the appropriate time frames, or are not held in inventory for the 3-year period, or if modifications are combined with subcontracts, DCAA cannot appropriately consider them for audit. We believe these deficiencies warrant your attention because they could increase the government's vulnerability to defective pricing. We would appreciate your informing us of the actions you intend to take to resolve the deficiencies.

SCOPE AND METHODOLOGY

The deficiencies discussed in this letter were found during our work on DCAA's subcontract defective pricing inventory. Our observations are based on the information DCAA provided on the 25 contracts (located at 15 DCAA field offices) that DCAA was aware of. In determining whether contracts were included in inventories in a timely manner, DCAA did not specify a contract award cut-off date for the years 1985-1990. Therefore, for those years we used a cut-off date 6 months before the date DCAA required field offices to have their inventories prepared. For 1991, we used the 2 month time period specified in DCAA guidance.

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Please contact me at (202) 275-8400 if you or your staff have any questions concerning this letter.

Sincerely yours,



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