



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

National Security and
International Affairs Division

B-277209

July 8, 1997

The Honorable Barbara Boxer
The Honorable Charles E. Grassley
The Honorable Tom Harkin
United States Senate

Subject: Impact of Legislative Compensation Caps on DOD Contracts

In response to your request, we have developed information on the extent to which legislative caps have affected executive compensation allowable under Department of Defense (DOD) contracts. Specifically, we obtained compensation costs from the Defense Contract Audit Agency (DCAA) for McDonnell Douglas Corporation for 1995, the latest year of a completed DCAA incurred cost audit. We also obtained from DCAA nine other contractors' estimates of the impact of legislative compensation caps on their companies. On June 3, 1997, we briefed your staff on the results of our work. This report summarizes the information provided at that briefing.

BACKGROUND

The Congress has placed various limitations on the amount of compensation costs that may be allowed on defense contracts.

The fiscal year 1995 DOD Appropriations Act (P.L. 103-335) provided that, "After April 15, 1995, none of the funds provided in this Act may be obligated for payment on new contracts on which allowable costs charged to the government include payments for individual compensation at a rate in excess of \$250,000 per year."

The fiscal year 1996 DOD Appropriations Act (P.L. 104-61) provided that, "None of the funds provided in this Act may be obligated for payment on new contracts on which allowable costs charged to the government include payments for individual compensation at a rate in excess of \$200,000 per year after July 1, 1996. . ."

The fiscal year 1997 DOD Appropriations Act (P.L. 104-208) provided that, "None of the funds provided in this Act may be obligated for payment on new contracts on which allowable costs charged to the government include payments for individual compensation at a rate in excess of \$250,000 per year."¹

RESULTS IN BRIEF

The information we collected on McDonnell Douglas Corporation and nine other contractors indicates that the compensation cap imposed on DOD contractors for fiscal year 1995, had no significant effect on limiting executive compensation charged to defense contracts for 1995. For McDonnell Douglas Corporation, which had about \$33.7 million in executive compensation in excess of \$250,000, only about \$313,000, or less than 1 percent, is estimated to be limited by the fiscal year 1995 compensation cap. Estimates by the nine other defense contractors of excess compensation costs subject to the fiscal year 1995 compensation cap range from 0.14 to 3 percent. The limited impact of the legislative compensation cap was primarily due to the short period the cap was in effect during 1995 (5-1/2 months) and the small amount of costs associated with new contracts entered into during this period using fiscal year 1995 appropriations.

For some of the same reasons, the amount of executive compensation charged to defense contracts in fiscal year 1996 will not be significantly affected, although the amount determined to be unallowable will increase because both the fiscal year 1995 and 1996 limitations were in effect. McDonnell Douglas Corporation estimates that only about 3 percent of 1996 executive compensation in excess of the cap will be subject to the fiscal year 1995 and 1996 compensation caps. Aggregated data on the effect of the 1997 cap was not available at the time of our review. Enclosure I contains more information on our findings.

AGENCY COMMENTS AND OUR EVALUATION

DOD provided written comments on a draft of this report. DOD took no exception to the information provided in the report regarding the allowable cost impact of the statutory compensation caps. However, it commented on the substantial administrative burden imposed on both DOD personnel and defense contractors by the inconsistencies between the four different compensation caps enacted by the Congress over the past 3 years.

¹A statutory compensation limitation was also imposed by the Fiscal Year 1997 National Defense Authorization Act (P.L. 104-201) on both DOD and civilian government agencies, but this limitation affected fewer executives than that imposed by the Fiscal Year 1997 DOD Appropriations Act.

The nature and extent of the administrative burden was not the focus of our review. However, DOD identifies a pertinent issue. Generally speaking, it seems reasonable that more consistent treatment of compensation caps could ease implementation problems. DOD's comments are provided in enclosure II.

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We are providing copies of this correspondence to the Secretary of Defense, the Director of the Office of Management and Budget, and other appropriate congressional committees and members. We will also make copies available to others on request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this briefing report. Major contributors to this report are Charles W. Thompson and Robert D. Spence.

A handwritten signature in cursive script that reads "David E. Cooper". The signature is written in black ink and is positioned above the typed name and title.

David E. Cooper
Associate Director
Defense Acquisitions Issues

Enclosures - 2

INFORMATION ON
LEGISLATIVE COMPENSATION CAPS

**GAO Relevant DOD Compensation Caps
Provided in Laws**

Act	Cap	Applicable to	Covered compensation
FY 1995 Appropriations	\$250,000	DOD	Undefined (applied to total compensation)
FY 1996 Appropriations	\$200,000	DOD	Undefined (applied to total compensation)
FY 1997 Appropriations	\$250,000	DOD	Undefined (applied to wages and elective deferrals)
FY 1997 Authorization	\$250,000	DOD and civilian agencies	Wages and elective deferrals

^a For fiscal year 1997, the Federal Acquisition Regulation (FAR) interim rule applies to the top five senior officers.

**GAO FAR Definition of Compensation
Subject to Fiscal Year 1995 Cap**

- Salaries and wages
 - Directors' and executive committee members' fees
 - Bonuses (including stock bonuses)
 - Incentive awards
 - Employee stock options and stock appreciation rights
 - Employee stock ownership plans
 - Employee insurance
 - Fringe benefits
 - Contributions to pensions, other postretirement benefits, annuity, and employee incentive compensation plans
 - Allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost-of-living differential
 - Compensation for personal services under certain conditions
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GAO About McDonnell Douglas

- The McDonnell Douglas Corporation (MDC), headquartered in St. Louis, Missouri, manufactures military and commercial aircraft, missiles, and space and electronic systems
 - Most of MDC's work is under firm fixed-priced contracts
 - MDC sales were \$14.3 billion in fiscal year 1995 and \$13.8 billion in fiscal year 1996; approximately 70 percent of sales were to the U.S. government
 - MDC total employment was 63,873 in December 1996, including 649 employees at MDC's headquarters office
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GAO Percent of MDC Excess Compensation Covered by Cap in FY 1995

	Total compensation in excess of \$250,000	DCAA and contractor estimates of amounts in excess of \$250,000 subject to FY 1995 compensation cap	Percent subject to cap
Headquarters office	\$13,365,275	\$178,855 ^a	1.34
Headquarters and component offices	\$33,748,375	\$313,090 ^b	0.93 ^c

^a Defense Contract Audit Agency (DCAA) recommended this amount based on the results of its audit.

^b MDC components voluntarily removed this amount from overhead cost submittals (subject to DCAA audit).

^c MDC estimates the percentage for 1996 to be less than 3 percent.

GAO MDC 1995 Compensation
For Top Five Executives

Executive ^a	Amount ^b
1	\$4,012,833
2	3,920,559
3	2,383,974
4	2,303,713
5	2,238,966
Total	\$14,860,045

^a Because these amounts differ from Securities and Exchange Commission filings, MDC requested that the names of the executives not be disclosed.

^b These amounts represent compensation as defined by the FAR and differ from compensation reported in Securities and Exchange Commission filings.

GAO Other Contractor Estimates of Excess Compensation Covered by Cap in 1995

Contractor	Percent of excess compensation subject to cap
A	0.33
B	1.50
C	3.00
D	0.14
E	2.00
F	0.67
G	1.67
H	1.20
I	2.00

COMMENTS FROM
THE DEPARTMENT OF DEFENSE



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

June 27, 1997

Mr. Louis J. Rodrigues
Director, Defense Acquisitions Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Rodrigues:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "IMPACT of LEGISLATIVE COMPENSATION CAP on DOD CONTRACTS," dated June 13, 1997 (GAO Code 707253/OSD Case 1387). While we take no exception to the information provided therein regarding the allowable cost impact of the statutory compensation caps, we are disappointed that your report does not also address the substantial administrative burden imposed on both DoD personnel and defense contractors by those caps. We believe that an appreciation of this problem is essential for a complete understanding of the impact of the statutory compensation caps on DoD contracts.

Much of this administrative burden is directly attributable to the inconsistencies between the four different compensation caps enacted by the Congress over the past three years. These include the variations in cap amounts, periods of applicability, funding limitations, definitions of compensation, and universes of capped employees, as well as the disparate treatment of DoD and civilian agency contracts. Because of these complexities, defense contractors have found it extremely difficult and time-consuming to comply with the statutory compensation caps, which can actually necessitate the negotiation of multiple overhead rates for the same contractor fiscal year. Moreover, these same complexities have made DoD auditors and contract administrators' jobs of reviewing contractor compliance with the statutory compensation caps significantly more difficult.

We appreciate the opportunity to focus attention on this important additional impact of the statutory caps on allowable contractor compensation costs.

Sincerely,

Eleanor R. Spector
Director, Defense Procurement



(707253)

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