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Brigadier General M. W. Baker 723
 Commander, Headquarters
 Air Force Contract Management Division
 Kirtland Air Force Base
 New Mexico 87117

Dear General Baker

The Los Angeles Regional Office has recently completed a survey of the settlement of noncompliance cases involving Cost Accounting Standards (CAS) at the Air Force Plant Representative Office, Northrop Corporation, Hawthorne, California. The objective of the survey was to determine whether the administrative contracting officer (ACO) took timely and appropriate action to settle reported cases of contractor noncompliance with CAS during 1975 and 1976. C1428

We found that timely and appropriate action had been taken by the ACO in processing noncompliance cases in accordance with the requirements of the Armed Services Procurement Regulation 3-1212. One case, however, was settled on the basis of direction from higher headquarters, which we believe requires reconsideration by your staff. The details of the noncompliance case is presented as follows.

The ACO had requested that the resident Defense Contract Audit Agency determine whether expenses incurred in the preparation of cost performance reports (CPR's) for F-5E/F aircraft under Foreign Military Sales contracts for delivery to Saudi Arabia were recorded in a manner consistent with applicable CAS requirements. The auditor advised the ACO on May 7, 1976, that the contractor was in noncompliance with CAS 402, Consistency in Allocating Costs Incurred for the Same Purpose. The noncompliance involved two Air Force contracts in which proposed labor and related expenses for preparation of CPR's was estimated as direct costs. The contractor's established practice was to account for such expenses as indirect costs.

The ACO made an initial determination of noncompliance on May 17, 1976. In commenting on this matter, the contractor stated that the CPR's in question were special requirements directed by the Air Force and were in addition to the cost reports provided on other contracts.

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Since the contracts in question required splitting one CPR into two reports, the contractor felt justified in proposing and accounting for the expenses of the second set of reports as direct costs.

Subsequently, the ACO prepared a draft determination of non-compliance and submitted it to the AFCEID Staff Judge Advocate for recommendation and guidance. The matter was then referred to the Air Force Systems Command Staff Judge Advocate. The ACO was advised by Systems Command on October 7, 1976, that the noncompliance was unwarranted and should not be issued. The basis for the decision was that CPR's relating to aircraft sales to Saudi Arabia were specifically required by the contracts to serve a peculiar purpose. The ACO promptly notified the contractor that direct charging of the CPR preparation costs was acceptable for the Saudi Arabia effort, provided that the CAS Disclosure Statement was revised and consistently followed.

File documentation obtained from your resident contract administration personnel at Northrop strongly supports the view that the CPR's serve the same purpose, that is, to enhance Air Force management capability in the identification and analysis of program problems. If the Saudi Arabian requirements had been negotiated with Northrop on a separate Air Force contract, the costs of the CPR would have been accounted for as an indirect expense in accordance with the company's normal procedures. We would appreciate it if your staff would reconsider this matter and advise us of any action taken or planned.

We would like to take this opportunity to acknowledge the courtesy and cooperation provided by your resident staff during this survey. A copy of this letter is being provided to the Regional Manager, Defense Contract Audit Agency, Los Angeles, and Air Force Plant Representative, Northrop, for information purposes.

Sincerely yours,



J T Hall, Jr.
Regional Manager

cc Regional Manager, DCAA, Los Angeles
AFPR, Northrop