United States General Accounting Office 129530

GAO

Report to Chairman, Committee on Appropriations
House of Representatives

March 1986

COST ACCOUNTING STANDARD 414

Its Relationship to DOD Profit Policy

GAO/NSIAD-86-55

035031

GAO

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

National Security and International
Affairs Division

B-159896

March 14, 1986

The Honorable Jamie L. Whitten
Chairman, Committee on
Appropriations
House of Representatives

Dear Mr. Chairman:

In the committee report on the 1984 legislative Appropriation Bill and a subsequent letter from Chairman Addabbo, Subcommittee on Defense, House Committee on Appropriations, you asked us to study Cost Accounting Standard (CAS) 414 and the Department of Defense's (DOD's) profit policy. Your request arose from a concern regarding DOD's introduction of cost of money[1] as an allowable contract cost as a part of its profit policy revisions in October 1976.

Your request raised three issues:

- whether CAS 414 (which establishes a method for measuring the cost of money for a contract) has continued relevance in light of current profit policy;
- whether DOD's profit policy, that permits the facilities investment value to be used twice in the computation of profit objectives, results in "double-dipping"; and
- whether CAS 414, in the context of DOD's profit policy, induces investment in cost reducing facilities.

This report addresses the first two of these three issues. More specifically, it describes the interrelationship between CAS 414 and DOD's profit policy. An important element of DOD's 1976 revision to its policy is the steps it took to preclude overall increases in profit recovery. In light of the concerns about over recovery, this report examines these steps and their impact on profits.

We are continuing to look at the third issue, whether CAS 414, in the context of DOD profit policy, induces investment in cost reducing facilities. Our previous work indicates that investment in facilities by defense contractors has increased since 1976. Whether there has been a corresponding increase in productivity is much more difficult to determine.

[1] An imputed cost determined by applying an interest rate, published by the Department of the Treasury, to a contractor's net book value of facilities capital. Cost of money is normally treated as a contract cost; however, in analyzing profit levels, DOD includes cost of money in negotiated profits.

In December 1983, DOD initiated a full-scale study and evaluation of its profit policy. The study's goal is to recommend changes in contract pricing, financing, and profit policies. This study, entitled Defense Financial and Investment Review (DFAIR), includes a review of whether current profit policy, including recognizing cost of money as an allowable cost, has induced contractors to invest in cost reducing facilities. The report on DFAIR has now been issued. The major focus of the study was to measure the level of realized profits at major defense contractor profit centers (segments). This profitability was compared to the profitability of comparable commercial corporations. Comparing profitability is an integral part of DFAIR's efforts in assessing the effectiveness of the existing profit and pricing policies. We are reviewing the DFAIR study effort and plan to report on our evaluation.

DOD Profit Policy

The profit policy provides contracting officers a structured approach to calculating prenegotiation profit objectives through weighted guidelines. The profit objectives determined through use of the weighted guidelines, coupled with the government's estimate of contract cost, produces the government "target" price used by the contracting officer in negotiating with a potential contractor.

Before October 1976, the profit policy had three main categories of profit objectives, which were (1) estimated contract cost (contractor effort), (2) contract risk, and (3) past performance. A profit objective for each category was computed essentially the same way. A contracting officer selected a specific profit rate from a range provided by the policy guidance and applied the rate to the estimated contract cost. Under this system the level of estimated contract cost had a direct bearing on the dollar value of the overall prenegotiation profit objective. Under this approach, if estimated contract cost increased so would the prenegotiation profit objective, all other things being held constant. When the profit objective established by a contracting officer increases, it is likely that negotiated profits will also increase.

In the 1970s, concerns surfaced that the heavily cost based profit policy produced disincentives for contractors to invest in productivity enhancing equipment because this equipment would decrease production costs with a corresponding decline in profits as estimated costs are lowered. This concern lead to the establishment of the Profit '76 Study. The study found that while defense contractors had a slightly higher return on assets than durable goods producers, the defense contractors had substantially less investment in facilities. The defense contractors'

lower level of facilities investment led the study group to conclude that productivity would probably increase if defense contractors increased their facilities investments. This increase in investments was expected to decrease the production costs and consequently decrease overall costs to the government. The study recommended that less emphasis be placed on contract cost and more emphasis be placed on investment. It was hoped that these changes would help remove disincentives to contractor investment in productivity enhancing assets.

The Profit '76 Study also found a relatively small difference in the average profit between cost type and fixed-price type contracts. This finding was supported by a survey of contracting officers, conducted as part of the study, which indicated that there should be a greater distinction between the contract risk profit ranges for cost type and fixed-price type contracts. The Profit '76 Study recommended a 1-percent increase in the risk profit ranges for fixed-price type contracts. This was intended to further reward contractors for the greater risk associated with fixed-price contracts.

On October 1, 1976, DOD introduced cost of money as an allowable contract cost and revised its profit policy to implement the recommendations of the Profit '76 Study. In establishing the revised profit policy, DOD sought to increase profit in those cases where the contractor's investment and risk was higher. However, DOD did not intend for these revisions to increase, for at least a transition period, total defense industry profits that were then being negotiated. It was believed that by changing the way profit objectives were computed, DOD would redistribute profits rather than increase them. The revised policy would more clearly recognize and reward investments (existing and new) at the expense of profit based on cost. We supported this thrust. In three earlier reports[2] we concluded that DOD should increase its emphasis on capital investment and decrease its emphasis on estimated cost in developing negotiated profit rates.

It was anticipated that these revisions would result in a redistribution of profit among defense contractors without increasing 1975 profits in the aggregate. The policy revisions were designed to reward contractors with larger amounts of facilities capital and to penalize those with smaller amounts of facilities capital. This report is not suggesting that

[2]Defense Industry Profit Study (B-159896, Mar. 17, 1971). Letter to the Secretary of Defense (GAO/PSAD-77-75, Feb. 17, 1977). Recent Changes in the Defense Department's Profit Policy: Intended Results Not Achieved (GAO/PSAD-79-38, Mar. 8, 1979).

profits should remain at the level they were in 1975. If the changes in policy were effective in removing obstacles in cost-reducing facilities investment, contract costs would be reduced due to increased efficiencies, and profits expressed as a percentage of cost would increase, and therefore, profits in the aggregate could increase.

Our review showed that overall profit objectives did increase after the 1976 policy revision. Although part of this increase could be attributed to the policy working as intended, a significant portion of the increase was due to flaws in the offset design which are discussed on pages 6 an 7 of this letter.

The major revisions (shown in table 1) to the policy introduced two nev opportunities for profit related to facility investment, and an increased recognition of risk for fixed-price type contracts as opposed to cost typ contracts. To offset these increased profit allowances, the policy reduced profit based on contract cost and eliminated the allowance of profit based on a contractor's past performance.

Table 1: Major Policy Revisions

	Increased and new profit allowances		Reduced and eliminated profit allowances
1.	Facilities investment (new) (a) allow as a contract cost the cost of money measured in accordance with CAS 414 (b) create a profit factor linked to the facilities capital investment	1. 2.	Profit on cost (reduced) (a) profit objectives based on estimated contract costs reduced Past performance as a profit objectiv (eliminated)
2.	Contract risk (increased) (a) the relative profit range on fixed-price type contracts was increased		

There were three principal elements in DOD's revised profit policy. The first element of DOD's revisions recognized a contractor's investment in facilities associated with a contract, both as a cost and as an element of profit. While DOD recognized that allowing the cost of money would provide increased recovery to contractors, it was anticipated that the increased investment would enhance productivity, thereby lowering production costs.

In addition to recognizing the cost of money as an allowable contract cost, DOD created a profit factor linked to facilities investment. The dollar value of facilities investment for a contract is computed by dividing the contract cost of money by a interest rate used to compute the cost of money. This figure is then multiplied by a profit rate chosen

from a range provided in the weighted guidelines. From October 1976 to February 1980, this rate ranged from 6 to 10 percent. It is this dual recognition of contractors' facilities, both in cost of money and profit on facilities investment, which led to concerns about double dipping or double recovery. While the facilities investment value enters into the calculation of profit objectives twice, this does not constitute double dipping. DOD took steps to prevent this double dipping by designing the offset factor discussed below.

An important element of the new policy was to offset these increased profit allowances by reducing the cost based profit allowances. Under the revised policy, the overall profit objective based on estimated cost is multiplied by .7 (the offset factor), resulting in a 30-percent reduction from the previously calculated profit objective on estimated cost. A less significant element affecting the redistribution was the elimination of past performance as a profit objective. The intent of the 30-percent offset and elimination of past performance was to fully offset the increases allowed for investment (including cost of money) and contract risk.

The third element of DOD's revision was to increase the profit range for contract risk. While contract risk was a factor in the profit policy before October 1976, under the new policy it was increased for fixed-price type contracts to more fully reward contractor's risk and provide a greater spread between profit on cost type versus fixed-price type contracts.

The recognition of investment was made possible in part by the Cost Accounting Standards Board promulgation of CAS 414, Cost of Money as an Element of the Cost of Facilities Capital. CAS 414 provides a basis for measuring and allocating to contracts the imputed economic cost of capital invested in facilities used for contract performance. Essentially, the Standard provides uniform techniques to measure the total cost of money associated with a segment's investment in facilities and to allocate this cost to individual contracts. In the current profit policy, facilities investment is one of the significant bases used for determining profit objectives. We believe that investment by a contractor should be a major consideration in determining the profit to be negotiated for each contract. CAS 414 is a device used by DOD to identify capital facilities with individual contracts. As such it is an integral part of DOD's profit policy. Therefore, the standard is relevant as a means for measuring the total cost of money associated with investments in facilities and to allocate this cost to individual contracts, and is necessary if investment continues to be a basis for developing profit objectives.

In February 1980, an additional DOD action—Defense Acquisition Circular (DAC) 76-23—was taken to further encourage contractor investment. The profit range of 6 to 10 percent used in calculating profit on facilities investment was increased to 16 to 20 percent. However, unlike the adjustments made in 1976, there was no increase in the offset to the profit objective. Therefore, profit objectives increased significantly.

DOD's intent in developing the offset factor to reduce profit objectives based on cost was an attempt to ensure that the overall cost to the government would not rise as a result of its revised profit and pricing policies. Thus, at the time the revised policy was implemented, profits in the aggregate would be kept constant with more heavily invested contractors gaining in profit at the expense of lightly invested contractors. As previously mentioned, it was recognized that over the long term, as contractors made investments in productivity enhancing assets which reduce costs, profits would increase, presumably to be matched by a decrease in production costs.

Our review showed that overall profit objectives have increased significantly. For example, in the first year of the policy, fiscal year 1977, net profit objectives increased by more than $40 million. Increases occurred for each year thereafter.

We believe that flaws in the offset design are responsible for a significant portion of these increases. These flaws are:

1. DOD's assumption that only 52 percent of the dollar value of all contracts were fixed price was too low.

2. In February 1980, DOD issued DAC 76-23, which increased the profit objective range for facilities capital employed from 6 to 10 percent to 16 to 20 percent without increasing the 30-percent offset factor. In fiscal year 1981, the first year after DOD more than doubled the profit range on facilities investment, net profit objectives increased by $113 million, which represented approximately a threefold increase over the increase for the previous year.

Although there were net increases in profit objectives before 1980 and the implementation of DAC 76-23, table I.1 indicates how significant this change was. Our observations are confirmed by DOD's recent DFAIR study which indicates that DAC 76-23 resulted in an unintentional increase in profit by .5 percent to 1 percent.

The DFAIR study confirms that DOD's February 1980 decision—DAC 76-23—resulted in unintended increases in profit objectives. It follows that if the level of contractor profit parallels the level of the profit objectives, and if the level of contract awards or procurement authorization continues to be in excess of $100 billion as it has each year since 1982, then DOD could be annually paying somewhere between $500 million and $1 billion more in contractor profit than it intends.

While we did not analyze each of the potential causes for increases in profit objectives, we believe that the above mentioned flaws in the policy's design, including the decision not to increase the offset in February 1980, are responsible for a significant portion of the increased profit objectives.

Conclusions

CAS 414 is relevant because it provides a means to measure and allocate cost of money and consistently identify the amount of facilities capital associated with a contract. We have previously recommended that investment should be a significant element in profit determination and DOD's current policy makes use of investment for profit determination. If investment is to be continued as a profit determinant, CAS 414 performs a necessary function.

If the offset policy remains part of the profit policy, DOD should reevaluate the validity of the assumptions used in its design of the policy and its decision not to adjust the offset as conditions change. We believe that adjustments should be made to the offset whenever there are changes in the conditions on which the policy was based.

The DFAIR study concludes, "Increased markups of .5 to 1 point resulting from DAC 76-23 were unintended." It recommends that a new, revised "Markup policy should yield results which are on average .5 to 1 point lower than results achieved under DAC 76-23." The preliminary results of our review of the DFAIR report indicate that none of the alternative recommendations set forth in DFAIR's revised markup policy will have the desired objective of reducing profits by .5 to 1 percent.

The results of DAC 76-23 of providing negotiated profits resulting in profits .5 to 1 percent higher than expected, as cited in the DFAIR report, are consistent with the findings of this report. Therefore, pending a more detailed analysis of the changes suggested by the DFAIR report, DOD should take action immediately to reduce the unintended profit resulting

from the implementation of DAC 76-23. Several approaches would accomplish this reduction. One approach would be to rescind DAC 76-23. An advantage to this approach is that it would be a straightforward solution. A disadvantage is that it may reduce contractor investment incentives. Other approaches include (1) increasing the offset to more than the current 30 percent or (2) instructing contracting officers to reduce the profit calculated under the current weighted guidelines by .5 to 1 percent. Adopting one of the above approaches would stop the continued awarding of profits in excess of those intended until appropriate revisions are made to the profit policy.

Agency and Other Comments and Our Evaluation

DOD reviewed a draft of this report and concurred with the conclusion that CAS 414 is still relevant to the DOD procurement policy. However, it disagreed with several other aspects of the draft report. In particular, it disagreed with the assessment that the 30-percent offset was intended to cover the three elements of increased profit objectives: (1) cost of money on facilities, (2) profit on facilities, and (3) risk. DOD also disagreed with the draft report's conclusion about the length of time that the offset was intended to preclude, in the aggregate, increases in profit objectives.

DOD officials stated that the intent in developing the offset factor was to insure that at the time of transition to the new policy, the increases in profit objectives would be reduced by decreases caused by the offset factor and the elimination of past performance. They added that it was never intended for future profits to be kept at the same average level that existed in 1975. They stated that as conditions changed, profits would also change.

We have carefully reviewed the evidence surrounding the development of the revised profit policy and the offset factor, and continue to believe the 30-percent offset to profit objectives based on estimated cost and the elimination of profit based on past performance were intended to cover all three increases in profit objectives. Our position is based on an internal DOD memorandum, which formed the conceptual framework of the offset under the new policy, the implementing document for Defense Procurement Circular (DPC) 76-3, dated September 1, 1976; the Air Force Systems Command Profit Study '82; and DOD's answers for the record to questions submitted at hearings on March 14, 1984, before the Subcommittee on Defense, House Committee on Appropriations.

Although the concept of the offset being operable only in a transitional period was not articulated in the record when the policy was revised in 1976, we agree that as conditions change from those used in developing the revised profit policy such as contractors' increased facilities investment, and increased use of fixed-price contracts, profit rates are likely to change. We did not intend to suggest that profits should remain at 1975 levels and have made appropriate clarifications. However, notwithstanding DOD's assertion in its comments on the draft of this report that changes in profit policy are likely to change profit rates, its DFAIR report concluded that the profit policy initiated by DAC 76-23 increased markup by .5 to 1 percent more than intended.

We received comments from individuals prominent in, and knowledgeable about, government procurement. Their comments, which covered a wide variety of issues, along with DOD's comments, are analyzed in appendix III.

Sincerely yours,

Frank C. Conahan
Director

DOD's Profit Policy and How It Relates To CAS 414

Background

During the late 1960s and early 1970s, DOD officials and others became concerned about the reluctance of defense contractors to invest in productivity enhancing machinery and equipment for use in the performance of government contracts. They believed that the DOD procurement policy was a major reason for the limited investment because in setting profit objectives, the procurement policy failed to recognize facility investment, which is necessary for efficient operation.

In 1975 a study commonly referred to as Profit '76 was undertaken, followed by a new profit policy. Where DOD was preparing to revise the profit policy, the CAS was preparing to issue CAS 414, Cost of Money as an Element of the Cost of Facilities Capital. The standard's purpose is to establish criteria for measuring and allocating the cost of capital committed to facilities as an element of contract cost. Consistent application of these criteria will improve cost measurement by providing for allocating the cost of contractor investment in facilities capital to negotiated contracts.

Two important changes involving facilities capital were made to the DOD procurement policy. DOD recognized

- the level of facility investment identified with a contract in reaching its prenegotiation profit objective and
- the imputed cost of capital for facility investment identified with a contract (cost of money) as an allowable cost on most negotiated contracts.

The Congress, the CAS Board, and others encouraged DOD to consider the effect of CAS 414 before the new profit policy was finalized. Specifically, they felt that some reductions in negotiated profits should be made to compensate for allowing cost of money under government contract cost principles. The belief was expressed that if an offset or reduction in profit was not made, contractors would recover cost of money as an allowable cost and as a part of profit; thus, contract prices would increase.

Redirecting the Profit Policy Emphasis

DOD designed its profit policy, implemented under DPC 76-3 (effective 10/1/76), to accomplish several major objectives. The policy was designed to place less emphasis on profit based on estimated cost, delete past performance as a basis for profit, recognize contractor investment as part of the basis for profit, increase profit for risk, and recognize cost of money as an allowable cost. These changes were made to help remove disincentives for contractor facility investment decisions. It was

expected that the revised policies would lead to the establishment of more equitable profit objectives[1] on DOD contracts and that contractors would respond to these incentives by increasing facilities investment and reduce labor costs, thereby achieving greater profits as a percentage of cost and at the same time offering lower overall prices to the government.

Defense contractors with large facility investments would be rewarded with additional profit and those with little facility investment would receive less profit than they had previously received. The idea was not to increase total defense industry profits, but to redistribute profit on a more equitable basis through the use of cost of money and profit on facilities capital employed.

CAS 414

CAS 414 became effective on October 1, 1976. The CAS Board determined that the economic cost of capital committed to facilities or cost of money was real and relevant for government contract costing. The CAS Board recognized the significant impact such a standard could have on the procurement process. For that reason, in its prefatory comments, it expressed the belief that CAS 414 need have no impact on the aggregate prices paid by the government under negotiated contracts. The Board held this view since it understood that procurement agencies expected to take this standard into account in their pricing policies.

The purpose of the standard, as stated by the Board, is to establish criteria for measuring and allocating the cost of capital committed to facilities as an element of contract cost. CAS 414 establishes the method for measuring the net book value of capital assets committed to a contract. This net book value of assets then becomes the base to which an interest rate is applied. The rate applied is a semiannual interest rate established by the Secretary of the Treasury pursuant to Public Law 92-41 (85 Stat. 97).

In addressing the question of whether CAS 414 is relevant in light of current DOD profit and pricing policies, we considered the standard from two perspectives: (1) as a criterion for the measurement and allocation of the cost of capital and (2) as an element of the profit policy, which allows cost of money identified by the standard, as a contract cost. CAS 414 is relevant in that it serves the purpose for which it was written;

[1]A profit objective is that part of the estimated contract price objective, which in the judgment of the contract officer, is an appropriate profit for use in the negotiation process.

that is, it established criteria for measuring and allocating the cost of capital committed to facilities as an element of contract cost. It is a tool that provides a consistent identification of the amount of facilities investment associated with a contract. In the current profit policy, facility investment is one of the bases for determining profit objectives. Therefore, it is necessary to have a technique which provides for the consistent identification of facility investment used on a contract. CAS 414 fulfills this need and for that reason is relevant.

Computing the Cost of Money as an Element of Contract Cost

The investment base used in computing the cost of money for facilities capital is computed from accounting data used for contract costing purposes. The base is the average net book value of capital assets for a cost accounting period. The cost of money for a segment (e.g., a division of a company) for that period is calculated by multiplying the applicable Treasury interest rate times the net book value figure. The asset values are allocated to indirect cost pools, such as engineering overhead, manufacturing overhead, and general and administrative expense.

Cost of money is computed on the facilities capital in each indirect cost pool by multiplying the asset value assigned to the pool by the interest rate specified by the Secretary of the Treasury. For example, if the interest rate is 10 percent and the average net book value of assets assigned to a contractor's engineering overhead cost pool was $1 million, the cost of money would be $100,000 for a 1-year period. The cost of money for each overhead cost pool is added together to arrive at total cost of money for the contractor segment for the accounting period.

Allocating the Cost of Money to a Contract

Cost of money factors are computed for the assets attributable to each of a contractor's overhead cost pools by dividing the amount of cost of money by the unit of measurement of the distribution base—for example, direct labor dollars, machine hours, or total cost input—used to allocate the expenses of the pool. For example, an engineering overhead pool with a computed cost of money of $100,000 allocated by direct labor dollars totaling $5 million has a cost of money factor of .02 (i.e., $100,000 ÷ $5 million, has a cost of money factor of .02). The total unit of measure (direct labor dollars) used to allocate an expense pool refers to all work done in the organizational unit, not just work done for the government.

To distribute the engineering pool cost of money to a specific contract, the total unit of measurement, that is engineering direct labor dollars,

identified with the contract, is multiplied by the cost of money factor. Using the previous example, if the direct labor dollars from the engineering pool applicable to a contract is $2 million, and the cost of money factor is .02, the cost of money applicable to the contract from this pool would be $40,000. This $40,000 would be recognized as allowable cost on the contract. Other government contracts with the same contractor organizational unit would also have portions of the remaining $60,000 in cost of money recognized as allowable cost. This procedure is repeated for each overhead cost pool.

CAS 414 as a Tool to Measure the Amount of Contract Facility Capital

Providing a profit objective for facilities capital employed under DOD's new profit policy established the need to identify the facilities capital employed by contract. The amount of facilities capital employed assignable to a contract is directly related to the amount of cost of money, which is as described above, applicable to the contract. After the amount of cost of money for a specific contract is determined, the facilities capital employed is determined by dividing cost of money by the specified applicable Treasury rate. If, as in our above example, the total cost of money allocable to a contract is $40,000, then at a 10-percent Treasury rate for cost of money, the facility capital employed associated with the contract would be $400,000. This dollar value of facilities capital employed on a contract is then used to calculate a profit objective for facilities capital employed. The 1976 policy set the prenegotiation profit weight for facilities investment between 6 to 10 percent. Thus, in our example, a profit objective for this facilities capital employed, calculated at the mid-point of the 6 to 10 percent weight range (8 percent), would be $32,000.

Appearance of Duplicate Recovery

The process of calculating cost of money begins with the contractor's total facility capital net book value. Cost of money is computed by applying the Treasury interest rate to this book value. In the above hypothetical example, the engineering overhead pool had an average net book value of $1 million of assets. For the hypothetical contract, $40,000 of cost of money was calculated and recognized as allowable cost. Then at a 10-percent interest rate, the average net book value of the assets identified with the contract was $400,000. This contract net book value is used to calculate the $32,000 profit objective on the same facilities capital employed. This use of the facilities capital employed figure twice raises the question of duplicate recovery or double dipping. Using this figure twice does result in duplicate recovery, or profit, based

on the same facilities, but for two distinct purposes. However, to prevent an increase in overall profit levels being negotiated at the time the new policy was put into effect, DOD developed an offset factor to reduce the profit objective based on estimated cost. As discussed below and shown in table I.1 of this appendix, the offset did not fully cover the increases in cost of money, facilities capital employed, and contract risk, even in 1977—the first year of transition.

The Offset

DOD implements its profit policy through the use of the weighted guidelines method—a technique for computing an overall profit objective. Generally, government negotiators are directed to use profit objectives when negotiating a contract. Under weighted guidelines, a profit objective is determined for several profit factors. The major factors used in determining the overall profit objective for a contract are (1) profit on estimated cost (excluding cost of money), (2) profit for risk, and (3) profit for investment. The sum of the profit objectives for these factors, plus cost of money,[2] represents the overall profit objective for a contract. Our report deals with profit objectives and not negotiated or realized profits.

One of DOD's primary goals in revising its profit policy was to reduce emphasis on cost as a profit determinant. Therefore, DOD developed the offset factor to be applied to the profit objective based on the estimated cost in a contract. Under weighted guidelines, an individual profit objective is determined for each estimated cost category—material, engineering labor, and so forth—in which costs are accumulated. The sum of the individual profit objectives for estimated cost is multiplied by .7 (the offset factor) to arrive at the reduced profit objective on estimated cost.

This 30-percent reduction, along with the deletion of profit on past performance,[3] was intended to offset (1) an increasing profit for risk, (2) recognizing profit on facility capital employed, and (3) allowing cost of money. If these adjustments are not adequate to accomplish all intended purposes, overall profit objectives will increase. When net profit objectives are increased, it is likely that the ultimate effect will be that negotiated profits are also increased. That is, if the government begins

[2]For the purpose of reporting negotiated profits, DOD includes the negotiated cost of money as part of profit.

[3]Before revising the profit policy under DPC 76-3, a profit objective existed for past performance. Historically, it had represented a relatively small portion of overall profit objectives. Under DPC 76-3, this profit objective was deleted.

negotiations with a higher profit objective, it can be expected that the ultimate negotiated profit will be higher than if one started at a lower level.

Midcourse Correction Further Increased Profit Objectives DAC 76-23

A major objective in revising DOD's profit policy as a result of Profit '76 was to deemphasize profit based on cost while emphasizing investment as a basis for profit. While DPC 76-3 achieved this objective to a degree by establishing a profit objective based on investment, DOD recognized that the prenegotiation profit objective for investment was modest and would likely be increased in future years. Since 1971, we have advocated greater recognition of contractor capital (investment) in determining profit objectives for negotiating government contracts.[4]

In February 1980, DOD made several changes in its profit policy as part of a midcourse correction in DAC 76-23. DOD formally removed labor intensive Research and Development (R&D) and service contracts from the provisions of DPC 76-3 and provided new weighted guidelines for these contracts. DAC 76-23 also made adjustments for contract risk profit objectives. These included reducing the profit range on cost plus fixed-fee contracts by .5 percent. On incentive contracts, it established specific ranges for single and multiple incentive contracts. The most significant change under DAC 76-23, however, was the increase in profit range for facilities capital employed. This range increased from 6 to 10 percent to 16 to 20 percent.

In 1979 we recommended that, with respect to the then current profit range of 6 to 10 percent on facilities capital employed, DOD should substantially increase the emphasis on facilities and further reduce the portion of profit objective for estimated contract cost. While DAC 76-23 more than doubled the weight range to profit objectives for facilities capital employed on manufacturing contracts, no change was made to the 30-percent offset to the profit objective based on estimated cost. The overall effect of these policy changes was a further increase in net profit objectives for such contracts.

[4]Defense Industry Profit Study (B-159896, 3/17/71). Letter to the Secretary of Defense (GAO/PSAD-77-75, 2/17/77). Recent Changes in the Defense Department's Profit Policy: Intended Results Not Achieved (GAO/PSAD-79-38, 3/8/79).

Why and How Profit Objectives Increased

When DOD implemented its revised policy in DPC 76-3, it did not intend for these revisions to increase, for at least a transition period, total defense industry profits that were being negotiated at that time. It was believed that by the changes, DOD would redistribute rather than increase overall profits. The revised policy would more clearly recognize and reward investments at the expense of profit based on cost. However, our review showed that even in the first year of the policy revisions, DOD's reductions in profit objectives have not fully compensated for the three increases; that is (1) the recognition of cost of money, (2) profit on facility capital employed, and (3) increased profit for risk. As a result, profit objectives increased in the aggregate. Theoretically, this should not have happened because based on DOD's new policy, capital intensive contracts would receive more profits while less capital intensive contracts would receive less.

Some of the increases in negotiated profits in years following 1977 shown on table I.1 can be attributed to the intended effects of the profit policy. However, we believe that flaws in the design of the offset are responsible for a significant portion of these increases.

Conceptual Flaws in Policy Design

In this study, we reviewed the conceptual development and assumptions, including the profit increases and the balancing offset on which the revised profit policy was based. There appear to be at least two reasons which contribute to the fact that the adjustments were not adequate to cover the increases in profit components. One reason was the assumption regarding the ratio of the dollar volume of fixed-price type contracts to the total dollar volume of all contracts. The second reason was the decision in 1980 to increase the profit objective for facilities capital employed without a balancing reduction in other profit objectives.

- Under the new profit policy, DOD increased the profit objective range for risk by 1 percent of the total estimated cost of fixed-price type contracts. Profit objectives for other than fixed-price contracts were not increased. In establishing the new policy, DOD estimated that 52 percent of the dollar value of all contract awards was for fixed-price type contracts. To the extent that the dollar value of fixed-price contracts exceeded the 52 percent of the whole, either the offset factor would have to be increased or the allowance for risk would have to be

decreased to avoid a net increase in profit objectives. Using DOD published contract profit data[5] from 1969 through 1974, we found that fixed-price type contracts accounted for 61 percent of the contract dollar value.

- In February 1980, DOD issued DAC 76-23, which among other things, increased the profit weight range factor for facilities capital employed from 6 to 10 percent to 16 to 20 percent. The regulation did not, however, increase the 30-percent offset factor applicable to the profit objective on estimated cost. This resulted in negotiated profits, in the aggregate, increasing for manufacturing contracts.

Analysis of Data From DD Form 1499 Files

In addition to examining the concepts and assumptions on which the profit policy was based, we analyzed reported profit objective figures and cost of money data included in DOD computer files of DD Form 1499—Report of Individual Contract Profit Plan. The purpose of DD Form 1499 is to provide DOD a basis for analyzing profit negotiating patterns and weighted guideline profit objectives on defense contract actions.[6] We used the data to analyze the dollar value of increased profit objectives for cost of money, increased profit for facilities capital employed, and increased contract risk. The DD Form 1499 computer files available at the time of our review contained information on profit and cost of money for 14,454 contract actions from October 1977 through September 1983. Of this universe, the offset factor was used to compute a profit objective for 8,477 contracts.

Our analysis of this data for 8,477 contracts shows that the 30-percent reduction to the profit objective for estimated cost and the deletion of past performance profit was not large enough to compensate for the increases starting the first year, 1977. Data we reviewed from October 1976 through February 1980, the time period which coincides with the effective dates of DPC 76-3, included 4,029 contract actions. This data indicated that increases in profit objectives of facilities capital employed, contract risk, and allowances for cost of money, amounted to

[5]Profit rates on negotiated prime contracts fiscal year 1976, DOD, Office of the Assistant Secretary of Defense (Comptroller) Directorate of Information, Operations, and Control.

[6]A DD Form 1499 is prepared for each negotiation of a contractual agreement involving a separate cost and profit that together total more than $500,000 or more (32 C.F.R. § 21-302(a)). However, DOD computer files do not contain a record for each contract action over $500,000. We analyzed all computer records made available by DOD.

$756 million. The 30-percent offset to profit objectives based on estimated cost and the deletion of the profit objective based on past performance for these contracts was $657 million. This was a net increase in profit objectives of $99 million.

We also reviewed DD Form 1499 data from March 1980 through September 1982. This was after the midcourse correction made by DAC 76-23. This data covered 3,000 contract actions and indicated that the increase in profit objectives for the three profit elements referenced above was $1,007 million, while the 30-percent offset and deletion of past performance was $570 million. This was a net increase in profit objectives of $437 million.

Since issuing the draft report, we updated our analysis to include more current data. For the most recent data available, October 1982 through September 1983, 1,448 contract actions indicate that the net increase in profit objectives was $481 million. These changes in profit objectives are summarized in table I.1.

Table I.1: Effect of the Profit Policy on Aggregate Profit Objectives for Selected DOD Contract Actions[a]

Dollars in millions

Additions or increases	Oct. 1976 to Feb. 1980	Mar. 1980 to Sept. 1982	Oct. 1982 to Sept. 1983
Profit on facilities capital employed	$215	$439	$406
Profit for contract risk	306	218	274
Allowance of cost of money	235	350	330
Total	**756**	**1,007**	**1,010**
Decreases			
Past performance[b]	92	83	81
30-percent reduction to profit objective based on estimated cost	565	487	448
	657	570	529
Net increase in profit objectives	$99	$437	$481

[a]The universe of contract actions reviewed consisted of the entire DD Form 1499 data system at the time of our review. From October 1976 through February 1980, we included 4,029 contract actions where cost of money was recognized and the DOD offset factor was used. For March 1980 through September 1982, we included 3,000 such contract actions. For October 1982 through September 1983, we included 1,448 contract actions.

[b]Profit on past performance was deleted when DOD revised its policy in 1976.

A factor which contributed to the increase in the allowance of cost of money and consequently to the net increase in profit objectives was the increase in the Treasury cost of money rate over the period of analysis. From October 1976 to February 1980, the Treasury rate increased to

12.25 percent. The average rate for the period was 8.74 percent. The increase in the annual rates over the 8-percent rate used in establishing the offset accounted for $20 million of the $235 million increase in cost of money during the time period. From March 1980 to September 1983, the corresponding average was 13.83 percent. This increase in the Treasury rates accounted for $287 million of the $680 million increase in cost of money for this period.

Conclusions

We believe CAS 414 is valid as a cost accounting standard. The Standard provides a means to measure and allocate cost of money and consistently identify the amount of facility capital committed to a contract. This is necessary if investment is to be a basis for developing a profit objective.

DOD attempted to take the effect of cost of money and other increases in profit objectives into account when it revised its profit policy in 1976. Cost of money, which was implicitly included as a part of profit before Profit '76, was to be balanced by an offset against profit objectives based on estimated cost so that the overall cost to the government would not increase.

The offset factor, which has been fixed at 30 percent since its development in 1976, was designed to place less emphasis on estimated cost as a basis for profit. This offset, along with the deletion of profit objectives based on past performance, was designed to offset (1) cost of money, (2) the increased profit objectives for contract risk, and (3) the recognition of facility capital investment as a basis for profit. Since the first year under the revised policy (1977), the reductions to profit objectives have been too small to compensate for the overall increases in profit objectives. DOD's 1980 revisions to its profit policy further increased the overall defense contract profit objectives for facilities capital employed without a counterbalancing reduction in other profit objectives. The net effect has been that the overall profit objectives have been increasing.

We are not suggesting that profits should remain at 1975 levels. However, we do believe that profits should not increase merely because conditions change, but rather because the objectives of the policy are being achieved; that is, cost would be reduced so that overall prices do not increase. We look to DFAIR to address the question of the effectiveness of the policy at reducing cost.

The recently released DFAIR study concludes increased markups of .5 to 1 point resulting from DAC 76-23 were unintended. It recommends that a new, revised "Markup policy should yield results which are on average .5 to 1 point lower than results achieved under DAC 76-23." The preliminary results of our review of the DFAIR report indicate that none of the policy alternates set forth in DFAIR's recommended markup policy will have the desired results of reducing profits by .5 to 1 percent.

The results of DAC 76-23 of providing negotiated profits of .5 to 1 percent higher than expected as cited in the DFAIR report, are consistent with the findings of this report. Therefore, pending a more detailed analysis of the changes suggested by the DFAIR report, DOD should take action immediately to reduce the unintended profit resulting from the implementation of DAC 76-23. Several approaches would accomplish this reduction. One approach would be to rescind DAC 76-23. An advantage to this approach is that it would be a straightforward solution. A disadvantage is that it may reduce contractor investment incentives. Other approaches include (1) increasing the offset to more than the current 30 percent or (2) instructing contracting officers to reduce the profit calculated under the current weighted guidelines by .5 to 1 percent. Adopting one of the above approaches would stop the continued awarding of profits in excess of those intended until a full evaluation of DFAIR can be completed and appropriate revisions are made in the profit policy.

Objectives, Scope, and Methodology

The objectives of our review were to examine revisions to the profit policy since 1976 and attempt to answer two questions: (1) Is CAS 414 relevant in light of DOD profit policy and (2) does allowing cost of money and providing profit on facilities capital employed permit duplicate recovery or "double dipping"? We sought to obtain a historical perspective of DOD's profit policy and CAS 414 and establish the relationship between profit and cost of money. For reporting purposes, DOD includes cost of money in negotiated profits. Consequently, in this study, we also treat cost of money as though it was part of profit. Our review included an examination of profit objectives, not negotiated profit nor realized profits. A profit objective is that part of an estimated price, which in the judgment of the contracting officer, is an appropriate profit for use in the negotiation process.

We analyzed the changes made to the DOD profit policy since the Profit '76 Study, the reasons for the changes, and the effect of changes on contract profit objectives.

We reviewed CAS Board records and other documents pertinent to the promulgation of CAS 414 and DOD's profit policy. We reviewed the Profit '76 report and related study files, other published reports and documents on DOD's profit policy, CAS 414, and investment. We discussed the profit policy and CAS 414 with persons associated with the Profit '76 Study and DOD officials involved in the current profit study. We reviewed our previous reports and correspondence relative to the subject matter of this review.

We used the computer files from the DD Form 1499—Report of Individual Contract Profit Plan—to measure the changes in profit objectives arising from the policy revisions. The DOD computer data we reviewed included prenegotiation profit objectives and cost of money data for 14,454 Army, Navy, and Air Force contracts from 1977 through 1983. Contracts of $500,000 or more negotiated by various service buying activities are included in the computer file. However, the file does not contain all DOD contract actions over $500,000 and cannot be used to project results. We did not test the extent to which the contracts, which should have been reported, actually were reported.

We analyzed the data and made tests which we considered necessary to establish the reasonableness of aggregate data used in computing cost of money and the profit objective. However, we did not do a full-scale reliability assessment. In establishing the reasonableness of the aggregate data, we determined that the computation of cost of money and the

profit objective conformed to DOD policies. We determined that in the aggregate,

- the cost of money objective was calculated at the cost of money rate set by the Secretary of the Treasury for the period analyzed,
- profit rates for risk fell within the profit rate range set by the DOD policy by type of contract,
- profit rates for facility capital employed fell within the appropriate profit rate range set by the DOD policy, and
- profit on estimated cost was reduced by the DOD 30-percent offset.

We used the DD Form 1499 computer data to determine the adequacy of DOD's offset and provide some perspective as to the effect of the profit policy revisions on aggregate profit objectives.

Our review was performed in accordance with generally accepted government auditing standards.

Comments From DOD and Other Interested Parties

We received official oral comments from DOD on our draft report. DOD's comments were largely concerned with four issues.

1. The offset: what it was intended to cover.

2. The offset: how long was it intended to work.

3. Conceptual flaws in the policy design.

4. Other changes we did not consider.

In addition to DOD's formal comments, we sought unofficial comments of prominent members of the defense procurement community. Their comments varied widely. However, they raised an additional issue.

5. We should use the actual increase in contract risk profit for fixed-price type contracts.

1. The Offset: What It Was Designed To Cover

DOD and some of the procurement experts took exception with our statement that the offset was intended to cover the three changes to profit objectives instituted by DPC 76-3. The three changes were increases in profit objectives on (1) contract risk, (2) profit on facilities capital employed, and (3) allowance of cost of money. DOD stated that the 30-percent reduction was developed to offset only profit on facilities investment and cost of money. The procurement experts, while raising this issue, were not in agreement as to which profit objectives the offset was intended to cover.

We have carefully reviewed the evidence surrounding the development of the revised profit policy and offset factor and can reach no conclusions other than, at the time of the policy's implementation, the 30-percent offset to profit objectives, based on estimated cost, was intended to cover all three increases in profit objectives. The evidence relied on includes a DOD memorandum, DPC 76-3 dated September 1, 1976, Air Force Systems Command Study Profit '82, and DOD responses to questions at the hearing before the Subcommittee on Defense, House Committee on Appropriations, on March 14, 1984.

For example, the following DOD answers to Committee questions are set forth in the report of hearings at the Subcommittee of the House Committee on Appropriations.

Question. Deemphasizing profit based on cost was accomplished by applying an adjustment factor of .7, or 70 percent of the profit objective for contractor total cost (i.e., a reduction of 30 percent). Did this .7 adjustment factor (30 percent reduction) make up for (1) increased profit weight for cost risk, (2) recognition of profit on facilities capital employed, and (3) recognition of cost of money as an allowable cost when the policy went into effect?

Answer. The .7, or 70 percent adjustment factor was designed to offset all three of the indicated factors, plus addition of the special productivity factor.

Question. What percentage of the adjustment factor was to compensate for each of the three changes, that is (1) cost risk, (2) recognition of facilities capital employed, and (3) allowability of cost of money?

Answer. The adjustment factor was intended to cover all changes, including the additional special productivity factor in the aggregate.

An Air Force report on DOD profits—Profit Study '82—stated the following in characterizing DPC 76-3, the regulation which promulgated profit revisions recommended by Profit '76.

"The recommended profit revisions Profit '76 were promulgated in DPC 76-3 in September 1976 and were designed to increase investment and productivity. The most important revisions were as follows:

—"The emphasis on CITP [Contractor Input to Total Performance], a measure of contractor effort under the Weighted Guidelines, was reduced from 65 percent to 50 percent of profit.

—"The emphasis on Contract Cost Risk was increased from 30 percent to 40 percent of profit. In general, the relative profit range on fixed-price type contracts was increased.

—"A new factor, Contractor Investment in Facilities Capital, was added to the Weighted Guidelines and represented 10 percent of profit.

—"The implicit recognition of cost of money on facilities capital was removed from profit and explicitly recognized as a contract cost under CAS 414.

—"A Special Productivity Factor was added to the Weighted Guidelines to return the lost profit opportunity caused by productivity increases which lower the cost base.

—"Because the relative weights of individual profit factors under the Weighted Guidelines format remained unchanged, a 30-percent degradation of CITP was created so that these profit policy revisions would not result in an overall increase in price to the government. This degradation was designed to offset the shift in emphasis, recognition of cost of money on facilities capital, etc. A popular misconception has been that the degradation was solely attributable to the recognition of cost of money on facilities capital."

These references and discussions we have had with individuals who are recognized as knowledgeable in the area reaffirm our conclusions regarding the intent of the 30-percent offset factor.

2. The Offset: How Long Was It Intended To Work

DOD and some commentators took exception to the draft report because it suggests that the offset was intended to prevent aggregate profit objective levels from rising over time. DOD stated that the intent in developing the offset factor was to insure that at the time of transition to the new policy, the increases in profit objectives would be offset by decreases caused by the offset. They stated that it was never intended that future profits were to be kept at the same average level that existed in 1975. They stated that DOD intended that as conditions changed profits would change also.

Although the concept of the offset being operable only in a transitional period was not articulated in the record when the policy was revised in 1976, we agree that as circumstances change, such as increased facilities investment and increased use of fixed-price contracts, profit rates are likely to change, and consequently, we are not suggesting that profits should remain at 1975 levels. However, we do believe that profits should not increase merely because circumstances change, but rather because the objectives of the policy are being achieved. For example, in fiscal year 1977, the first year under the revised profit policy, net profit objectives increased by more than $40 million. We believe this increase is the result of flaws in the design of the offsetting adjustments. Again in fiscal year 1981, the first year after DOD more than doubled the profit range on facilities investment, net profit objectives increased by $113 million, which represented an almost threefold increase over the previous fiscal year. This significant increase in profit objectives is due in part to DOD's decision not to increase the offsetting adjustments to balance the increase in profit on facilities investment. The net increase in fiscal years 1977 and 1981 do not appear to be the result of changes in contractor's investment patterns and/or improved efficiency. We believe that the existing flaws in the profit policy should be corrected and

future policy should be made flexible enough to adjust for changes in profit objectives arising from changes in conditions.

3. Conceptual Flaws In The Policy's Design

DOD and some other commentators disagreed with our explanation of conceptual flaws in the policy's design. The draft report cited three reasons the 30-percent offset was not sufficient to cover increases in profit objectives. In disagreeing with our explanation of why net profit objectives increased, DOD addressed two of the three reasons we cited.

(a) Cost of money fixed at 8 percent—DOD and others commented that increasing the offset to account for a rise in the Treasury rate above 8 percent would have defeated the intent of providing increased motivation for contractors to invest in labor saving capital equipment.

We are not suggesting that DOD adjust profit objectives to offset all cost of money being recognized as an allowable cost. The recognition of cost of money as well as other profit policy changes, was done to help remove disincentives for contractor facility investment decisions. However, profits should not increase merely because the cost of money rate increases, but rather increased investment has occurred. DOD and others did not concur with the draft report's characterization as a conceptual flaw the idea that the offset factor would not change as the Treasury interest rate changed. The report has been changed to delete that reference and, in lieu thereof, indicate in the text on pages 18 and 19 of appendix I, the dollar amounts of the increases in allowance of cost of money which are attributable to Treasury interest rates being above the 8-percent used by DOD in the original offset calculations.

(b) The level of fixed-price type contracts used in designing the offset—DOD and other commentators did not agree with our conclusion that the ratio of fixed-price type contracts to cost type contracts used in developing the offset was too low. As covered in a previous comment, DOD stated that the offset did not include coverage of increased profit objectives arising from an increased profit range on contract risk. Even assuming that the offset was intended to cover the increase in risk, DOD and others commented that changes in the level of fixed-price type contracts should not be offset because it was not DOD's intent to continually adjust the offset to maintain 1975 profit levels.

The draft report cited the reliance on a 52-percent level of fixed-price contracts because those contracts received direct benefits from the

increase in the contract risk profit range. Reliance on the 52-percent level of fixed-price type contracts by DOD was based on the contract dollar distribution for 1 year, fiscal year 1975. We have reviewed the data and methodology available to DOD in establishing the ratio of fixed-price type contracts to cost type and found that for the 5 years before 1975 (1969 to 1974), the average was 61 percent. The 1975 level of 52 percent appears to be a statistical aberration and reliance on this 1 year data contributed to the finding that the decreases in profit objectives were not sufficient to cover the increases.

4. Other Changes To Profit Policy We Did Not Consider

DOD and some commentators pointed out that we did not consider other changes which were part of the revisions in the profit policy (both DPC 76-3 and DAC 76-23). These changes would tend to reduce the finding that net profit objectives increased. Specifically, DOD cited four changes (two related to each revision) which should be considered.

While we modified our calculations to accommodate some of these changes, they were not of sufficient magnitude to change our conclusions. (See app. I, pages 19 and 20.)

DPC 76-3

(1) DOD pointed out that contractors were no longer eligible for profit consideration based on their past performance.

In our original calculations, we did not consider adjustments to past performance. We have revised our calculations to include the elimination of past performance as a credit adjustment and have reflected the revised figures in the text and table I.1 in appendix I. (See pages 17 to 18.)

(2) DOD stated that in addition to past performance, there were other changes made under DPC 76-3.

We have reviewed these other less significant changes and find that they tend to be offsetting in nature. Accordingly, we have not adjusted our calculations to consider them.

DAC 76-23

(1) DOD said that we did not consider the removal of service and R&D contracts from under the DPC 76-3 policy. DOD suggests that as a result, services and R&D contracts had lower profit objectives. This lower profit

on service and R&D contracts should be included in any assessment of the change in profit objectives.

We considered the removal of service and R&D contracts from the provisions of DPC 76-3 in preparing our draft report. But, under the DD Form 1499 data system, it is not possible to establish the profit objective for service and R&D contracts awarded under DPC 76-3. Since we are unable to determine the actual change in profit objectives arising from this change, we have not adjusted our methodology.

Further, we disagree with DOD's position on the probable impact of removing service and R&D contracts from DPC 76-3. One of DOD's objectives in revising the profit policy and recognizing cost of money as an allowable cost was to redistribute profit. Defense contractors with large facility investment would be rewarded with additional profits and those with little facility investment would receive less profit than they had previously received. Service and R&D contracts are generally labor intensive and have less facility investment. Accordingly, as a group they were expected to receive less profit under DPC 76-3.

Since receiving comments on our draft report, DOD's DFAIR report has been released. On the subject of DAC 76-23, the report makes two points which are inconsistent with DOD's comments on our draft report. First, notwithstanding the lower profits that the revised policy would award to service and R&D contracts, the policy followed under DAC 76-23 resulted in average markups of .5 to 1 percentage points above those expected. Second, DFAIR recommends the elimination of the special weighted guidelines for service and R&D contracts and that those contracts use the weighted guidelines for all contracts. Both of these points are consistent with the findings of this report.

(2) DOD pointed out that we did not consider reduction in profit for contract risk on cost plus fixed fee and incentive fee and fixed-price incentive contracts.

We have revised our calculations to consider these changes and reflect the adjustments in our text and table I.1 in appendix I. (See pages 17 to 19.)

In summary, we have revised our calculations to reflect changes which DOD believed should also be considered. These adjustments do not alter our conclusions that adjustments which decreased profit objectives have not been sufficient to cover the increases in profit objectives.

Additional Comments From Prominent Procurement Experts

Comments received from prominent procurement executives raised an additional issue.

5. We Should Use The Actual Increase In Contract Risk Profit On Fixed-Price Type Contracts

One commentator suggested that instead of relying on an assumed 1-percent increase in contract risk profit for fixed-price type contracts, our analysis should consider the actual increase in contract risk profit.

In our draft report, we relied on the assumed 1 percent in an attempt to present a less complicated analysis. We had analyzed the actual increase for risk and found that it would have made the net increase in profit objectives even larger. This increase arising from using actual risk almost balanced the decrease arising from the elimination of past performance. In our draft report, both changes were left out in order to focus more attention on the major elements of the revised policy. Since many commentators have pointed out the need to consider these changes, we have included them in our calculations. While this results in some changes in the net increase in profit objectives, our finding of increased profit objectives remains. (See app. I, pages 17 through 20.)

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

340294

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

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100