



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

National Security and
International Affairs Division

B-276026

June 13, 1997

The Honorable Ted Stevens
Chairman
The Honorable Daniel K. Inouye
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

Subject: Defense Advisory and Assistance Service Contracts

In response to your request, we have reviewed selected aspects of the Department of Defense's (DOD) use of contracts for advisory and assistance services where subcontractors perform a substantial portion of the work.¹ This addresses your concerns and issues raised by your staff that prime contractors tasked with providing advisory and assistance services may be functioning principally as "clearinghouses" and may be performing little or no direct work while still charging up to 30 percent for managing subcontractor efforts. You also expressed concern about whether DOD has been providing the Congress accurate information on contracts for advisory and assistance services. For this review, we judgmentally selected a sample of five prime contracts, where subcontractors performed a significant portion of the work.

RESULTS IN BRIEF

The five prime contractors in our sample were providing advisory and assistance services and did not function principally as intermediaries, but rather

¹As defined in 31 U.S.C. 1105 (g), advisory and assistance services include management and professional support services; studies, analyses, and evaluations; and engineering and technical support services.

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performed substantial portions of the contracts' direct work.² The five prime contractors' costs and fees for managing subcontractors' efforts ranged from 2 to 8 percent of subcontract costs. Regarding your concern about whether DOD has been providing the Congress accurate information on advisory and assistance services, indications exist that DOD may have significantly underreported the amount of such costs.

CONTRACTOR MANAGEMENT FEES ON SELECTED CONTRACTS

The value of the five prime contracts we reviewed ranged from about \$51 million to \$113 million. For each contract, we reviewed documents covering a number of years, including payment vouchers, negotiation memoranda, and cost and price proposals. We focused our review on the amount that the prime contractors include in their general and administrative expenses, overhead costs, and profit for managing subcontractors' efforts. Our analysis showed that the prime contractors' indirect costs and fees for managing the subcontracted efforts ranged from about 2 percent to 8 percent of the subcontracts' costs. While subcontractors performed a substantial portion of the work, prime contractors also performed significant direct work and consequently did not function principally as nonvalue-added intermediaries.

The five contracts were funded from research, development, test and evaluation appropriations; procurement appropriations; and operations and maintenance appropriations. The statement of work for each contract was broad and provided for a range of technical and management services to assist selected procuring organizations.³ Because the detailed work requirements, timing, and definite cost of work could not be reasonably known when the basic contracts were awarded, the contracts were structured as task order or delivery order contracts. Detailed work requirements were established when separate task orders or delivery orders were issued.

² We contacted military organizations that administer contracts for technical services and they identified the five selected contracts for advisory and assistance services where subcontractors did a substantial portion of the work. Our analysis of the costs of administering subcontractor efforts is not generalizable to the entire population of advisory and assistance contracts.

³The statement of work is that portion of the contract that describes the actual work to be done by the contractor by means of (1) specifications, (2) quantities, (3) performance dates, (4) time and place of performance of services, and (5) quality requirements. It serves as a baseline against which progress and subsequent contractual changes are measured during contract performance.

ADVISORY AND ASSISTANCE COSTS MAY BE UNDERREPORTED

Our analysis of DOD's reporting for advisory and assistance services indicates that the amounts shown in the President's budget submission may not reflect the total amount spent for management and professional support services; analyses, and evaluations; and for relevant engineering and technical support services.

Title 31 U.S.C. 1105 requires annual budgetary reporting to the Congress of obligations for advisory and assistance services for the prior year and anticipated obligations through the current budget year. The Administration fulfills this requirement by including this information in the President's annual budget submission. The President's budget submission reported fiscal year 1996 obligations for DOD of about \$3 billion for advisory and assistance services contracts. Our analysis of data from DOD's contract action reporting system, however, indicated fiscal year 1996 obligations of almost \$12 billion for selected categories of services.⁴ Although the limited information obtained does not allow us to reconcile these amounts, our review indicates there may be substantial underreporting to the Congress.

The underreporting may be due to difficulties in accurately identifying advisory and assistance tasks. Several officials observed that the definition of advisory and assistance services was ambiguous, particularly for services related to research and development. At one location, an agency's review of contracts for advisory and assistance services revealed that inaccurate reporting was related to inadequate training of responsible staff.

Because congressional concern stems from both the cost and nature of advisory and assistance services, the Congress has, on occasion, imposed expenditure ceilings for such contracts. According to Office of Management and Budget guidance, when contractors provide advice and assistance that may affect decision-making, influence policy development, or provide support to project or program management, it is essential to ensure that the contractors' performance is free of potential conflicts of interest and does not impinge on the performance of inherently governmental functions by government employees. As such, advisory and assistance services require an appropriate degree of enhanced management and oversight. We plan to conduct a review to more fully examine the reasons for the possible underreporting on advisory and assistance services.

⁴We did not independently validate the data in DOD's contract action reporting system.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this letter, DOD concurred with our observations regarding costs to manage subcontractors, but disagreed that it had understated the cost of advisory and assistance services. DOD believes that in fiscal year 1996, the total cost for advisory and assistance services captured by its contract action reporting system was about \$1 billion below the \$3 billion reported to the Congress. However, DOD stated that such a variance was, undoubtedly, the result of legitimate differences in reporting criteria.

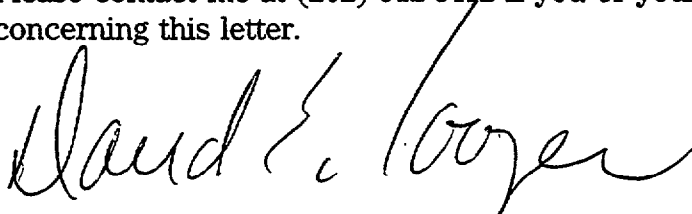
We based our observation on a comparison of costs reported under various categories of services in DOD's contract action reporting system and the costs reported to the Congress as part of the President's budget. We carefully examined the service categories included in DOD's contract action reporting system and conservatively selected 141 federal supply classes or service codes that could be advisory and assistance services. These totaled approximately \$12 billion. DOD's calculation does not include the majority of the dollars in the 141 federal supply classes or service codes that could be advisory and assistance services.

We have just initiated a follow-on review to examine the reasons for the variances between the amounts in DOD's contract action reporting system and the amounts reported to the Congress. DOD indicated that it stood ready to assist us in our planned review to examine the reporting of these costs.

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As we arranged with your office, unless you publicly announce this letter's contents earlier, we plan no further distribution of the letter until 7 days from its issue date. We will then send copies to the Chairmen and Ranking Minority Members of the House Committee on Appropriations, the Senate Committee on Armed Services, and the House Committee on National Security; the Director, Office of Management and Budget; and the Secretary of Defense. We will also make copies available to others on request.

Please contact me at (202) 512-8412 if you or your staff have any questions concerning this letter.



David E. Cooper
Associate Director, Defense Acquisition Issues

Enclosure



COMPTROLLER

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Mr. David E. Cooper
Associate Director, Defense Acquisitions Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft letter, "Defense Advisory and Assistance Services," dated May 27, 1997 (GAO Code 707223), OSD Case 1371. The DoD partially concurs with the draft letter.

Overall, DoD agrees with GAO that prime contractors for advisory and assistance services perform value added administrative and oversight efforts on contracts involving subcontractors. The DoD, however, does not agree that the cost of advisory and assistance services are underreported to the Congress. For the President's FY 98/99 budget, the Department made a concerted effort to ensure that the costs for advisory and assistance services reported to Congress via OMB were complete and accurate. This extra effort resulted in the identification and reporting of an additional \$.8 billion of advisory and assistance services for FY 1996 to 1999.

The GAO claimed that underreporting of costs may exist because DoD's contract action reporting system indicated higher totals for categories of services involving advising or assisting DoD management. For FY 96, however, the total cost for Advisory and Assistant Services coded in the contract action reporting system was actually about \$1.0 billion below the \$3.0 billion total reported to Congress in the President's FY 98/99 budget. Such a variance is, undoubtedly, the result of legitimate differences in reporting criteria. The official instructions and criteria for classifying and reporting advisory and assistance services are contained in DoD 7000.14-R, DoD Financial Management Regulation, Chapter 19. These instructions were used to report such costs to Congress.

The DoD believes there is no reason to conclude that the Department underreported the costs of advisory and assistance services to Congress. The DoD stands ready to assist the GAO in their planned review to examine the possibility of misreporting such costs.

Sincerely,

John J. Hamre

(707223)

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